Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD.
and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Because the issue was "outside the scope of the question presented" and was "not the basis for the decision below," this Court, in *Matsushita Electric Industrial Co., Ltd. v. Epstein*, 516 U.S. 367, 379 n.5 (1996), declined to consider petitioners' objection that full faith and credit could not be given to a Delaware class action judgment because the absent class members had been inadequately represented in Delaware. 516 U.S. at 379 n.5. Three concurring justices twice stated that this issue remained open on remand. 516 U.S. at 389, 399 (Ginsburg, J.). On remand, all four circuit judges who examined the record found inadequate representation, employing terms such as "hostile" and "subvers[ive]" representation, and "collusion" (App. 80a, 70a, 87a).

(1) Did a reconstituted panel majority err in concluding -- contrary to the decisions of this Court and every court of appeals that has considered the issue, the Restatement (Second) of Judgments, and the expressed views of three Justices in this very litigation -- that so long as a state has the functional equivalent of Rule 23, absent class members are bound by a class action judgment no matter how apparent from the record before the court that there was inadequate representation in fact?

(2) Does a class action settlement judgment accord absent class members due process when (a) there has been no inquiry into or record evidence concerning the named plaintiffs and their capacity to represent absent class members; and (b) the burden to prove inadequate representation was placed upon objectors, even though "suspicions [of collusion] abound" (App. 74a n. 17, 106a)?

(3) Despite this Court's explicit refusal to consider the issue and the separate statement by three Justices that the issue was open on remand, did this Court nonetheless oblige the court below to enforce a class action judgment that all members of that court believed was based on inadequate representation?

PARTIES TO THE PROCEEDING

The named plaintiffs in the federal class action, *Epstein, et al. v. MCA Inc., et al.*, No. 92-55675 (C.D. Cal.), are Lawrence Epstein, John Linder, and Jane Rockford (as trustee of the Michael J. Rockford Trust). Jane Rockford opted out of the Delaware class action and is not affected by the Delaware judgment, or the success or failure of this petition.

The defendants are MCA Inc., Matsushita Acquisition Corporation, Matsushita Electric Industrial Co., Ltd., Matsushita Holding Corporation, Lew Wasserman, and Sidney J. Sheinberg. All claims against MCA Inc., Lew Wasserman, and Sidney J. Sheinberg have been dismissed and those defendants are no longer parties to the action. Matsushita Acquisition Corporation no longer exists by virtue of having been merged into MCA Inc.

RULE 29.6 STATEMENT

All petitioners are individuals.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Lawrence Epstein, et al., respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is printed in Appendix A at 1a to 31a, and is reported at 179 F.3d 641. The court's earlier opinion is printed in Appendix B at 32a to 95a, and reported at 126 F.3d 1235.

JURISDICTION

The court of appeals entered its judgment on June 7, 1999. This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const. Amendment XIV provides in relevant part: " . . . nor shall any State deprive any person of life, liberty, or property, without due process of law."

28 USC § 1738 provides in relevant part: "Such Acts, records and judicial proceedings . . . shall have the same full faith and credit in every court within the United States . . . as they have . . . in the courts of such State . . . from which they are taken."

STATEMENT OF THE CASE

1. This securities law class action arose out of respondents' takeover of MCA. Alleging violations of the Exchange Act, which are within the exclusive jurisdiction of the federal courts, 15 U.S.C. § 78aa, petitioners instituted a proceeding in a California federal district court. Once the federal complaint was filed, the district court was informed that a Delaware class action asserting only state law claims had been settled and that it purported to compromise petitioners' federal claims. 516 U.S. at 389-90 (Ginsburg, J.). Rejecting the proposed settlement as "illusionary," the vice chancellor characterized the state law claims as "at best, extremely weak," and as having "little or no value." *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687 at 694, 696 (Del. Ch. Apr. 22, 1991). He added that "the *only* claims which have any substantial merit are the claims. . . in the California federal suit that were not asserted in this Delaware action." *Id.* at 696 (emphasis supplied).

The federal district court denied petitioners' motions for class certification and partial summary judgment and ultimately dismissed the federal claims. After petitioners had filed their opening brief in the Ninth Circuit, another settlement in the then completely "dormant" (516 U.S. at 392, Ginsburg, J.) Delaware proceeding was announced. Though stating that the benefits to the class were "meager" and that "suspicions [of collusion] abound," the vice chancellor approved the settlement as an exercise of his "own business judgment in deciding whether the settlement is reasonable . . ." (citation omitted) (App. 102a-103a, 106a). There was no evidence and the vice chancellor held no hearing to determine whether, at the time they sought certification as class representatives, the plaintiffs were even members of the class, held any non-time-barred federal claims, or that they otherwise adequately represented absent class members. Similarly, there was no evidence submitted to assure conflict-free representation by class counsel. Quite to the contrary: "suspicions [of collusion] abound" (App. 74a n. 17, 106a). But the vice chancellor said that the three individual objectors had not proved collusion (App. 106a). The individual objectors were neither authorized by absent class members, nor certified by the court, to represent the absent class members.

In the Ninth Circuit , defendants offered the Delaware judgment for its preclusive effect. 28 U.S.C. § 1738. Petitioners raised three bars to preclusion: the exclusively federal nature of the claims extinguished in the state court; the lack of adequate representation in Delaware violated due process; and "our federalism" prohibited such use of moribund state litigation to preempt the class's pending federal appeal. In *Epstein v. MCA, Inc.* ("*Epstein I*"), 50 F.3d 644 (1993), the Ninth Circuit reversed the district court's dismissal on the merits, granted plaintiffs partial summary judgment on liability, and ordered class certification. The court addressed only the first of plaintiffs' arguments against

preclusion. It refused to give the Delaware judgment full faith and credit because that judgment compromised claims within exclusive federal jurisdiction. So far as relevant here, defendants petitioned for and this Court granted certiorari limited to the exclusive jurisdiction issue.

2. In *Matsushita Industrial Electric Co., Ltd. v. Epstein*, 516 U.S. 367 (1996), this Court framed the issue before it as follows:

> This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

516 U.S. at 369. The Court unanimously answered that question in the negative.

Because the case was limited to that threshold question, the Court expressly declined to consider petitioners' due process objection to the preclusive effect of the Delaware judgment based upon inadequate representation:

> We need not address the due process claim, however, because it is outside the scope of the question presented in this Court. . . . While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. (Citations omitted.)

Id. at 379 n.5. Once again, the Court was unanimous.[1] While

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[1] Justices Stevens and Ginsburg dissented in part, on the issue whether the Supreme Court in the first instance should have construed the content of Delaware preclusion law.

three concurring justices (Ginsburg and Stevens, J.J., joined on this issue by Souter, J.) discussed the issue of adequacy of representation at length, *id.* at 389-99, they too left that issue for further consideration on remand. *Id.* at 399 (". . . this is a court of final review and not first view. . .").

3. *Epstein II.* On remand, a divided panel concluded that the Delaware judgment could not be given preclusive effect because both Delaware law and federal constitutional law prohibit enforcement of a judgment rendered in a class action proceeding in which the interests of absent class members were not adequately represented.

In an opinion for himself and Judge Wiggins, Judge Norris concluded that the issue of adequacy of representation by Delaware class counsel had not been "litigated" in Delaware; that even if it had been raised by the three appearing individual objectors, Delaware preclusion law would permit a collateral challenge by an absent class member; and finally, that in any event the due process clause required inquiry into adequacy of representation before the Delaware judgment could be given preclusive effect (App. 44-47a). Judge Norris focused at length on the inadequate representation by Delaware class counsel: "This was not merely 'inadequate' representation, it was *hostile* representation that [only] served the interests of counsel in getting a fee . . ." (emphasis supplied) (App. 80a). "Indeed, Delaware counsel's representation . . . surpassed inadequacy and sank to the *level of subversion*" (emphasis supplied) (App. 70a). In dissent, Judge O'Scannlain made no effort to defend the conduct of class counsel in Delaware. The situation suggested: ". . . dare I say, *collusive*, conduct of the Delaware class attorneys" (emphasis in the original) (App.89a). But, he said, "regrettably" (App. 83a), the Delaware court had resolved the issue, and its resolution barred any further inquiry.

4. *Epstein III*. Two days after *Epstein II* was filed, Judge Norris resigned. Respondents moved for rehearing, Judge Sidney Thomas was assigned to the panel, rehearing was granted, and the prior opinion was withdrawn on the votes of Judges O'Scannlain and Wiggins. Both judges, in different ways, believed that in *Matsushita*, despite footnote 5, this Court *implicitly* directed them to enforce the Delaware judgment. Judge Thomas dissented.

Judge O'Scannlain now concluded that although this Court's opinion "did not include an express statement that the Delaware judgment in question did not violate due process, *that conclusion was logically necessary to the Court's holding*" (emphasis supplied.) (App. 10a). He said that footnote 5 did not indicate otherwise (App. 13a-14a), and Justice Ginsburg's statement that the issue remained open was dismissed as being "part of her dissent" (App. 13a). Judge Wiggins' concurrence emphasized that, while Judge Norris had "convincingly" shown the existence of "hostile" representation by Delaware class counsel (App. 20a-21a), he now believed that this Court had sent "unmistakable signals" that "the Delaware courts likely had already conclusively resolved the due process issue" (App. 21a). He concluded that this resolution must be given full faith and credit in federal court, "irrespective of whether we agree with that determination" (App. 22a).

The court offered another -- and a far reaching proposition (App. 15a-19a). So long as the state has the functional equivalent of Rule 23, absent class members are bound by the class action judgment no matter how inadequate the class representation in fact:

> Simply put, the absent class members' due process right to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state

> system and by direct review in the United States Supreme Court.[2]

(App. 16a). Since the great majority of states have copied Rule 23 or adopted its functional equivalent, this means that there can be no collateral challenge based upon inadequate representation in fact.

Judge Thomas's dissent (App. 22a-31a) said that "the actual representation provided by Delaware class counsel was inadequate for the reasons persuasively detailed in Judge Norris's opinion on remand" (App. 26a). This conclusion encompassed the determination that Delaware counsel had given the Delaware courts a "misleading and incorrect" analysis of the federal litigation claims (App. 26a). But he also focused upon the purported Delaware class representatives. There was, he noted, no "record evidence that the class representatives were even members of the class" (App. 22a). Moreover, even if they were, at "the time settlement occurred, the statute of limitations prevented the Delaware class from litigating the federal claims in any Court" (App. 25a). Such class representatives "had absolutely no incentive to obtain fair valuation of the federal claims, because of their inability to assert the claims." *Ibid.* The panel's holding, he said, constituted a "license to those who would run to a favorable and remote state court to obtain settlements premised on bargain-basement valuations of federal claims, even when those claims clearly predominate over potential state causes of action" (App. 31a).

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[2] Collateral review for constitutional sufficiency of a class action judgment is limited to a consideration of "whether the *procedures* in the prior litigation afforded the party against whom the earlier judgment is asserted a 'full and fair opportunity' to litigate the claim or issue," he said (App. 17a) (emphasis added).

REASONS FOR GRANTING THE WRIT

The court of appeals enforced a class action judgment against absent class members despite the published conclusions of four circuit judges -- employing such terms as "hostile" and "subvers[ive]" and "collusion" -- that the class received inadequate representation. This decision conflicts with the settled law of this Court and other courts of appeals. Given the increasing willingness of, particularly state, courts to settle complex national class action litigation, and, as here, the frequent presence of competing and overlapping class actions in different courts, with "global" settlements available to representatives who submit the lowest bid, appropriate determination of adequate representation is essential. The decision below will have exceptional influence, if not reviewed. This Court's guidance is needed.

I. The rule announced by the court below states an unprecedented and wrong standard for evaluating an absent class member's claim that a state court judgment is not entitled to preclusive effect because it was obtained in proceedings where he or she was not adequately represented. By focusing solely on the procedure available under a state law rather than whether there was actually "adequate representation at all times" the announced rule eviscerates this Court's settled class action jurisprudence. *In the Ninth Circuit, if the opinion below stands, adequate representation does not mean adequate representation in fact by faithful class representatives; it means no more than the bare existence of adequate procedures.* This is a fundamental error in need of this Court's correction. If absent class members are to be bound by representation, this Court's cases teach that the absent class members must receive adequate representation in fact by faithful champions, and not simply have adequate procedures available to them. Otherwise, the class action mechanism creates an intolerable risk of abuse.

(i) The conclusion reached by the court below conflicts with a vast body of law. Since *Hansberry v. Lee*, 311 U.S. 32, 43 (1940), *a collateral attack case*, it has been clear that absent class members are bound only if "they are *in fact* adequately represented." (Emphasis supplied). *See also Richards v. Jefferson County, Alabama*, 517 U.S. 793, 800-801 (1996), another collateral attack case, quoting from *Hansberry*. Adequate representation must exist "at all times." *Phillips Petroleum Co. v. Shutts*, 472 U.S. U.S. 797, 812 (1985). *See also Ortiz v. Fibreboard Corp.*, 119 S.Ct. 2295, 2315 n.24 (1999) (quoting *Shutts* "at all times" language). As Justice Ginsburg said, 516 U.S. at 395, *Shutts's* phrase "at all times" means that "the class representative's duty to represent absent class members adequately is a continuing one." From *Hansberry* through *Ortiz*, an invariable theme runs through this Court's cases: If absent members are to be bound on the basis of representation, the class representatives (plaintiffs and counsel) must in fact act as faithful champions of the interests of class.

(ii) For the court below, class members must actively monitor and intervene in the class proceeding to protect their constitutional right to adequate representation. This is directly contrary to *Shutts*. *Shutts* said that, *unlike absent defendants*, absent class members are "not required to do anything", but could "sit back and allow the litigation to run its course." 472 U.S. at 810. Not so, according to the court below. Rather, to protect their rights, absent class members must hire counsel and actively monitor and intervene in all class proceedings; otherwise they are bound.[3] Simply put,

[3] Unlike non-appearing defendants who can collaterally attack a judgment for want of *in personam* jurisdiction, absent class members cannot make such an attack even though the existence of adequate representation "at all times" is a condition necessary for the existence of state court jurisdiction sufficient to bind absent class members. *See Martin v. Wilks*, 490 U.S. 755, 765 (1989). (Generally, the law imposes no duty to intervene in order to protect one's rights.)

an absent class member is and must act like a party "at all times."

II. A judgment that violates due process is not entitled to full faith and credit in "other state and federal courts." *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 482 (1982); 516 U.S. at 388 (Ginsburg, J.). The Delaware procedures were "fundamentally flawed." 456 U.S. 480. First, the Delaware court approved a class settlement without making any inquiry into adequacy of representation. There was no record evidence of any kind that, when they sought certification as class representatives, the putative Delaware class representatives were even members of the putative class, or that they held any claims when they sought certification as class representatives, that were not barred by the statute of limitations, as Judge Thomas observed (App. 25a-27a). Second, the vice chancellor placed the burden of proof on the individual objectors in the Delaware proceeding to prove *inadequate* representation, 516 U.S. at 399, Ginsburg, J., even though he recognized that "suspicions [of collusion] abound." Respondents conceded in this Court (App. 111a) that the burden of proof on adequate representation rests upon those who would create class certification and then a class settlement, not upon objectors who have never been designated class representatives. *See also Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 614 (1997). Moreover, the vice chancellor confused the need for proof of actual collusion with proof of inadequate representation.

III. Despite the Court's explicit statement that the issue of adequate representation would not be "address[ed]" because it was "outside of the scope of the question presented" and was "not the basis for the decision below," 516 U.S. at 379 n. 5, a panel majority, for differing reasons, believed that this language need not be taken at face value and that certain passages in this Court's opinion intimated or necessarily meant that petitioners' constitutional claims

should no longer be considered. This is profoundly alarming doctrine. Just as the lower courts must "leav[e] to this Court the prerogative of overruling its own decisions," *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989), so too must they leave to this Court alone the authority to say what it has and has not decided. Retention of this Court's prerogative is vital if this Court's dispositions are to have publicly intelligible meaning, and not simply constitute a trap for litigants who have unaddressed claims. It is an especially vital aspect of this Court's settled practice of limited grants of review. And it implements this Court's role as a "court of final review and not first view," 516 U.S. at 399 (Ginsburg, J.).

POINT I. A CLASS JUDGMENT BASED UPON INADEQUATE REPRESENTATION IN FACT IS NOT ENTITLED TO FULL FAITH AND CREDIT

The court below formulated a proposition deeply at variance with settled understanding: if the state court has Rule 23 or its functional equivalent (and all do), absent class members are conclusively bound by the judgment, no matter how inadequate the representation in fact.[4]

> Simply put, the absent class members' due process right to adequate representation is protected not by collateral review, but by the certifying court

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[4] Ignoring Justice Ginsburg's analysis of Delaware law and respondents' concession in this Court, referred to by Justice Ginsburg, 516 U.S. at 399 n.11, that Delaware *would* entertain a motion under Delaware Rule 60 to challenge inadequate representation, the majority below concluded that Delaware would not permit such a challenge (App. 15a n.6). In so holding, the court cited *Prezant v. De Angelis*, 636 A.2d 915 (Del. Supr. 1994) but ignored *Prezant*'s holding that due process required record based findings about the class representatives. 516 U.S. at 397 (Ginsburg, J.). *Prezant*, in turn, influenced this Court's holdings in *Amchem Products* and *Ortiz*, as to the necessity for adequate class plaintiffs.

> initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court.

(App. 16a). Since all states satisfy this condition, there is no collateral review in any court based upon inadequate representation in fact. The court's opinion is in direct conflict with an unbroken wall of authority in this Court from *Hansberry v. Lee* on down through *Amchem Products* and *Ortiz v. Fibreboard*. These opinions make clear that the class representatives (named plaintiffs and counsel) must be faithful champions of the interests of the class, if absent members are to be bound by the conduct of their "representatives". Insistence upon this requirement is of overriding importance in the context of classes certified for settlement purposes only. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 621 (1997); *Ortiz*, 119 S.Ct. at 2316.

1. In *Hansberry v. Lee*, a collateral challenge decision, the Court said that absent class members could be bound *only* if they appeared or were "*in fact* adequately represented . . ." 311 U.S. at 43 (italics added).[5] This was described as "familiar doctrine." *Id.* at 42-43. In *Richards v. Jefferson County, Alabama*, 517 U.S. 793, this Court began its opinion

[5] The court below incorrectly treats *Hansberry v. Lee* as having focused only upon matters of procedure governing the certification and conduct of class actions (App. 16a-17a). In *Hansberry*, nothing wrong was with the state court class action procedures. Indeed, in that proceeding there had been objectors who were in a position to make all available arguments, *Hansberry*, 311 U.S. at 41-43, and the collateral challenge was sustained on the substantive ground of inadequate representation in fact, *i.e.*, conflict of interest. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. at 808 n.1. (Class representatives' interests in *Hansberry* were in conflict with the interests of parties in the second action). To the same effect are the Court's more recent decisions in *Amchem*, 521 U.S. at 625-28 and *Ortiz*, 119 S.Ct. at 2318-21. Both decisions focused upon inadequate representation in fact because of intra class conflict.

by stating that "In *Hansberry v. Lee* . . ., we held that it would violate the Due Process Clause of the Fourteenth Amendment to bind litigants to a judgment rendered in an earlier litigation to which they were not parties and *in which they were not adequately represented.*" 517 U.S. at 794 (emphasis supplied). Later, in the opinion, at 800-801, the Court expressly quoted *Hansberry*'s "in fact" language. The class representatives must "adequately represent" the class *"at all times." Shutts,* 472 U.S. at 812 (emphasis supplied), *language that the court below never mentions. See also Ortiz v. Fibreboard Corp.*, 119 S.Ct. at 2315 n.24 (quoting the *Shutts* language). In holding to the contrary, the Ninth Circuit's opinion conflicts with the unanimous view of the lower courts, including the courts of appeals.[6] As Judge Becker, for example, said in *Real Estate Title*,[7] "it would violate due process to bind an absent class member to a judgment from a proceeding in which the member was not adequately represented." Such decisions clearly establish that the question of adequate representation in fact, not just upon

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[6] *See*, for example, *Gonzales v. Cassidy*, 474 F.2d 67, 75 (5th Cir. 1973), discussed by Justice Ginsburg, 516 U.S. at 395. *See also In re "Agent Orange" Product Liab. Litig.*, 996 F.2d 1425 (2nd Cir. 1993), permitting but rejecting on the merits a due process collateral attack on a prior opt-out settlement. *Id.* at 1432-1433 *et seq.* The court said that it "is axiomatic that a class action binds absent members only so long as they were adequately represented therein." *Id.* at 1435. "[A]fter judgment has been entered and subsequently is invoked against the class, the adequacy of representation is open to examination." F. James, G. Hazard, and J. Leubsdorf, *Civil Procedure* 631 (4th ed. 1992) (citing Restatement (Second) of Judgments § 42, comments e and f). *See* 3 Newberg and Conte, *Newberg on Class Actions*, §16.25 at pp. 16-133-137 (3d ed. 1992) (collecting authorities recognizing collateral attack from virtually every circuit).

[7] *In re Real Estate Title and Settlement Services Antitrust Litigation*, 869 F.2d 760, 767 (3rd Cir.), *cert. den.*, 493 U.S. 891 (1989).

the presence of procedures for determining adequate representation, are a necessary and appropriate basis for inquiry on collateral review.[8]

Adequate representation means adequate representation, not adequate procedures; it means vigorous representation *in fact* by faithful champions of interests of the class, not simply facially adequate procedures. Otherwise, the class action mechanism then becomes a license for grave abuse. As Judge Norris, citing *Hansberry*, said, "No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause" (emphasis supplied) (App. 56a).

2. The court below eviscerates *Shutts* in a second way. The effect of its holding is that, to protect their constitutional right to adequate representation "at all times", absent class members must actively monitor and indeed intervene in the class proceeding, otherwise they are bound however inadequate the representative in fact. Absent class members must, in short, retain counsel and monitor and intervene in every class action affecting their interests. This conclusion

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[8] The court refers to opinions from the First and Third Circuits. Nothing in their holdings or reasoning supports his far reaching proposition. In *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991) federal plaintiffs, upon commencement of a subsequent state action, intervened in the state action and litigated these claims all the way to the Delaware Supreme Court. They were properly barred by preclusion principles from relitigating those issues in the pending federal proceeding. *Hansberry v. Lee*, *supra*. In the Third Circuit's divided holding in *Grimes v. Vitalink*, 17 F.3d 1553 (3d Cir.), *cert. den.* 513 U.S. 986 (1994), a majority there said, *id.* at 1558, that the federal litigants *conceded* that they had, in fact, previously appeared and litigated the very issue in Delaware (in which case, of course, there would be preclusion). *Grimes* at the very least "leav[es] open whether one who did not object in state court could do so in federal court." Marcus and Sherman, *Complex Litigation*, p. 103 (Supp. 1997).

directly contradicts *Shutts*. There, rejecting attempts to analogize absent class members to defendants for purposes of establishing *in personam* jurisdiction, this Court said that, unlike a defendant, an absent class plaintiff "is not required to do anything." 472 U.S. at 810. For the court below, however, if an absent class member does not "do anything" before the class action judgment is entered, he is forever barred from challenging it. Absent class members are, therefore, in a position *worse* than defendants who, if they do not appear, can make a collateral challenge to the existence of *in personam* jurisdiction.

POINT II. THE DELAWARE CLASS JUDGMENT PROCEEDING WAS FUNDAMENTALLY FLAWED

A judgment that violates due process is not entitled to full faith and credit "in other state and federal courts." *Kremer v. Chemical Construction Co.*, 456 U.S. at 482; *see also* 516 U.S. at 388 (Ginsburg, J.). Here, the procedures were "fundamentally flawed." 456 U.S. at 480. While the vice chancellor's order recited that there was adequate representation, the class notice had not listed this as an issue; and there was no evidence with respect to the adequacy of representation by class counsel or the named plaintiffs. In particular, there was no record evidence that, at the time they sought certification as class representatives, the plaintiffs were even members of the class, or that they held any federal claims that were not barred by the statute of limitations. There must be evidence of some kind in the record, *Ortiz* 119 S.Ct. at 2316, of the existence of those conditions that are indispensable to representative status. Moreover, the vice chancellor placed the burden of proof on "collusion" on the objectors, not on the proponents of class certification. The "finding" or recital of adequate representation cannot overcome the glaring evidentiary defects.[9]

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[9] "[I]t must be taken to be established that a court cannot conclude all persons interested by its mere assertion of its own power (Cont'd)

1. Much of the various opinions below focused upon the conduct of Delaware class counsel. The judges below condemned it. But, as Judge Thomas recognized, *Amchem Products* once again makes clear that the class representatives also must be adequate (App.24a-25a). This is a "constitutional fact" the existence of which is necessary if absent class members are to be bound on the basis of representation alone. No court can enforce class action judgment without making a threshold due process inquiry into what the record shows with respect to the purported class representatives. This inquiry is especially crucial when the representatives have been certified for settlement purposes only. *Amchem Products*, 521 U.S. at 621; *Ortiz*, 119 S.Ct. at 2316. The panel majority, over Judge Thomas' dissent, declined to make that inquiry. Had it done so, it would see that there is not even a scintilla of evidence that would permit an inference that, at the time they sought certification as class representatives, the putative class representatives were adequate.

(i) As Judge Thomas said, *nothing in the record before the Delaware court showed that the purported Delaware representatives were even members of the class at the time they sought certification as class representatives* (App. 22a). The Delaware judgment thus squarely conflicts with this Court's precedents, which state categorically that "a class representative must be part of the class." *Amchem Products v. Windsor*, 521 U.S. at 625-26; *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 156 (1982).[10]

(Cont'd)
. . . even where its power depends upon a fact and it finds the fact." *Chicago Life Ins. Co. v. Cherry*, 244 U.S. 25, 29 (1917).

[10] "[A]ctual, not presumed, conformance with Rule 23(a) remains, however, indispensable." *General Telephone Co. of Southwest v. Falcon*, 457 U.S. at 160. This means that, "[a] class is
(Cont'd)

(ii) Even if the Delaware representatives had been shown to be class members, it is indisputable, as Judge Thomas also noted (App. 25a), that all their individual federal claims were barred by the statute of limitations. *At the point at which these Delaware class "representatives" sought certification as class representatives, they had no claims that they could litigate -- state or federal -- in any court.*[11] The Ninth Circuit decision conflicts with *Great Rivers Co-op of SE Iowa v. Farmland Indus., Inc.* 120 F.3d 893, 899 (8th Cir. 1997), which held that class members with time barred claims could not represent the class.[12] More importantly, the

(Cont'd)
not maintainable as a class action by virtue of its designation as such in the pleadings." *In re American Medical Systems, Inc.*, 75 F.3d 1069, 1079 (6th Cir. 1996). "To make an informed and independent judgment,. . . the court needs facts, not allegations." *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 437 (1968). Even if allegations in the complaint alone sufficed, the allegations of the Delaware complaints are insufficient. They are unverified. Moreover, the complaint alleges that the putative class representatives owned MCA shares at some point during the class period, not that they tendered their shares and, thus, potentially had rights under federal law.

[11] *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), holds that 1934 Act claims must be brought within one year of discovery. Under *American Pipe and Constr. Co. v. Utah*, 414 U.S. 538 (1974) and *Crown, Cork & Seal Co., Inc. v. Parker*, 462 U.S. 345 (1983), the statute is tolled once the complaint is filed only until the district court denies certification. The district court did so in April of 1991 and again on September 6, 1991. When the settlement was announced in October 1992, the statute had run even if September 6, the second *Epstein* certification denial, is viewed as the trigger date.

[12] Moreover, even if the Delaware plaintiffs could have asserted individual federal claims, any *class* action at this point in time would have been barred by limitations. Tolling does not extend to new class
(Cont'd)

certification of a class represented by representatives and counsel without any litigitable claims – state or federal – "did not support the essential premises" required for certification. *Ortiz*, 119 S.Ct. at 2316. The Delaware certification order thus conflicts with this Court's decisions in *Amchem Products* and *Ortiz*, both of which require that the putative class representatives must have litigable claims, and that class counsel's relationship to the claims not be conflicted.

We submit that inadequate representation exists as a matter of law when a class representative seeks certification for the purpose of releasing claims that "the representative" has no power to assert in any court, and when the representative thus sits at the bargaining table only because defendants have for their own purposes refrained from filing a dispositive motion. As Judge Thomas observed, such "[c]lass representatives ha[ve] absolutely no incentive to obtain fair valuation of the federal claims . . . ." (App.25a).

2. The vice chancellor not only made no inquiry into adequacy of representation; instead, he placed the burden of proof on the objectors to prove *inadequate* representation. 516 U.S. 399 (Ginsburg, J.). They, of course, were not appointed to represent the absent class members and make no commitment to undertake the fiduciary duties associated with that representation. In this Court respondents conceded that the burden of proof is on those who propose class certification and settlement, not those who oppose it (App. 111a). Allocation of burden of proof surely matters where "suspicions [of collusion] abound." Respondents made no

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(Cont'd)
action claims. *See Andrews v. Orr*, 851 F.2d 146, 149 (6th Cir. 1988): "The courts of appeals that have dealt with the issue appear to be in unanimous agreement that the pendency of a previously filed class action does not toll the limitations period for additional class actions by putative members of the original asserted class."

effort – none – to assuage the vice chancellor's concerns. It is, accordingly, irrational for respondents to argue that they discharged their burden when "suspicions [of collusion]" went unaddressed. Moreover, the vice chancellor employed the wrong constitutional standard. He confused proof of adequate representation with proof of collusion. Only the former is constitutionally relevant; and, quite clearly, that can be demonstrated without proving actual collusion between the class representatives and the defendants.

POINT III. THIS COURT HAS NOT DIRECTED THE COURT BELOW TO ENFORCE A CLASS ACTION JUDGMENT SECURED BY INADEQUATE REPRESENTATION.

At oral argument, petitioners sought to demonstrate inadequacy of representation, but this Court admonished counsel not to argue "on some peripheral issues that aren't here" (App. 113a). After that interchange, it was not surprising that the Court's opinion refused to address the issue of adequacy of representation because it was "outside the scope of the question presented" and was "not the basis for the decision below." 516 U.S. at 379 n.5. Nonetheless the panel majority believed that footnote 5 need not be taken at face value. Judge Wiggins believed that this Court sent "unmistakable signals" to enforce the Delaware judgment, and Judge O'Scannlain said that it was a "logically necessary" premise of this Court's disposition in *Matsushita*. These opinions empty footnote 5 of any meaning. Far more important, they compromise the public meaning of this Court's dispositions by setting traps for litigants as to what has and what has not been decided, *sub silentio*, despite this Court's explicit reservation of the very issue; they improperly impinge upon this Court's power to make limited grants of review. And they undercut this Court's role as a court of final review, not first view, which generally means that the

Court does "not decide in the first instance issues not decided below." *NCAA v. Smith*, 119 S.Ct. 924, 930 (1999).

Footnote 5 is a *holding of this Court*, one that was necessary for the full disposition of the petition since, in principle, a respondent may defend the judgment of the court below on any ground consistent with the record. *E.g.*, *Bennett v. Spear*, 520 U.S. 154, 166 (1997) (citing *Matsushita* for this proposition and the discretionary nature of the Court's authority in this respect). Just as the lower courts must "leav[e] to this Court the prerogative of overruling its own decisions." *Shearson/American Express*, 490 U.S. at 484, so too they must leave to this Court alone the authority to say what it has decided and what it has not. This Court has repeatedly relied upon *Matsushita* for the "we do not decide" proposition.[13]

1. Judge Wiggins apparently believed that this Court had held that the Delaware chancery court had resolved conclusively the issue of adequate representation and that was binding. This is wrong factually and constitutionally. First, this Court did not make such a determination. As Judge Thomas (App. 28a-30a), echoing Judge Norris's earlier exposition (App. 42a-44a), showed, the Delaware court had not resolved the issue. Moreover, the conduct of the Delaware objectors could not conclusively bind absent class members. "Objectors are objectors, not class representatives" (App. 45a). As Judge Thomas noted, "The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absent class members to represent

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[13] *E.g.*, *Holly Farms Corp. v. NLRB*, 517 U.S. 392, 400 n.7 (1996). In *Cass County, Minnesota v. Leech Lake Band of Chippewa Indians*, 524 U.S. 103, 1911 n.5 (1998), the Court expressly relied upon footnote 5 to justify the Court's refusal to decide an issue outside the scope of the question presented and that had not been addressed by the court below.

their interests, nor *were they certified by the state to do so*" (emphasis added) (App. 30a). This fact alone is fatal to attaching conclusive legal significance to the conduct of the Delaware objectors. *Richards v. Jefferson County, Alabama,* 517 U.S. at 801 (1996) (noting that plaintiffs in prior proceedings had not been designated as class representatives and thus could not bind absent class members). Additionally, if an objector could conclusively bind all other class members, "surely no objector could accomplish what a class member could not: binding a class without satisfying due process requirements."[14]

2. Abandoning his first opinion, Judge O'Scannlain said that this Court itself had itself resolved the due process issue. The "conclusion [that the Delaware judgment satisfied due process], was logically necessary to the Court's holding" (App. 10a). This is a striking analysis; if the Court had decided the due process issue implicitly, the explicit reservation in footnote 5 is meaningless. It is, however, his logic, not this Court's perception, that is flawed. There is no inconsistency in this Court having said: Respondents in *Matsushita* advanced two reasons for not enforcing the judgment. The first reason (here, state court release of federal claims within the exclusive jurisdiction of the federal courts) is not valid. But we do not address the question whether the second reason (inadequate representation) justifies not giving full faith and credit to that judgment. We are a court of last resort. The second issue is outside the question presented, and, it was not the basis of the decision below.[15]

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[14] Monaghan, *Antisuit Injunctions And Preclusion Against Absent Non Precedent Class Members*, 98 Colum. L. Rev. 1148, 1199 (1998). "The Epstein plaintiffs were not adequately represented in the Delaware state court proceedings by either the class representatives or the objectors . . ." (App. 31a) (Thomas, J.).

[15] Judge O'Scannlain's brief reliance upon *Kremer v. Chemical Construction Corp.*, 456 U.S. 461 (1982) (App. 10a, 17a), to support

(Cont'd)

Judge O'Scannlain also insists that "if the Epstein appellants' contention that the Delaware judgment is constitutionally infirm were true, *Matsushita* would be an advisory opinion" (App. 12a). This is plainly wrong. As Judge Thomas noted (App. 30a n.3), this Court conclusively resolved the statutory issue upon which it granted review. Nothing more is required to satisfy Article III. Otherwise, this Court's practice of limited grants of certiorari, as well as remands for further proceedings, are unconstitutional. The order entered by the Court, remanding for proceedings "consistent [or not inconsistent] with this opinion," 516 U.S. at 387, is fully consistent with this reasoning, and it is a recurring one. See Hart & Wechsler's, *The Federal Courts in the Federal System*, 507-508 (4th ed. 1996). That mandate leaves the court below entirely free to pass on any undetermined questions, and this frequently happens because limited grants by this Court are a commonplace. *Id.* at 487-89. That, on remand, the final judgment below might remain unaffected is quite common and always has been. See, for example, *State Tax Commission of Utah v. Van Cott*, 306 U.S. 511 *on remand*, 98 Utah 264, 96 P.2d 40 (1939).[16]

(Cont'd)
his "logically necessary" holding is mystifying. In *Kremer*, so far as relevant here, a federal court litigant challenged enforcement of a prior state court judgment because relevant state procedural law was, he alleged, "fundamentally flawed." *Id.* at *480*. Noting that a constitutionally infirm judgment cannot be given full faith and credit, *id.* at 482, this Court entertained the challenge; held that the state procedures did satisfy due process; and accordingly, it accorded full faith and credit to the state court judgment. 456 U.S. at 483-85. The challenge is to the class representative's failure to provide adequate representation "at all times". *Shutts, supra*. If that condition does not exist, the state court class action judgment violates due process and cannot be accorded full faith and credit. 516 U.S. at 388, Ginsburg, J.

[16] Later in his opinion, Judge O'Scannlain says, "We further note that where the Court leaves an issue open on remand, it often expressly
(Cont'd)

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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(Cont'd)
states that it is done so" (App. 14a). This is an obvious makeweight. "Often" is the key word here, otherwise the court has fashioned a novel clear statement rule: Unless magic words are used, this Court will be deemed to have set a trap for the unwary. Many decisions do not use these talismanic words, but it is apparent that issues remain open on remand. *E.g. Jefferson v. City of Tarrant, Ala.*, 118 S.Ct. 481, 483 (1997); *Pounders v. Watson*, 521 U.S. 982, 989-990 (1997); *Suitum v. Tahoe Regional Planning Agency*, 520 U.S. 725, 728-29 (1997); *General Motors Corp. v. Tracy*, 519 U.S. 278, 305 n. 13 (1991). Moreover, insistence upon a magic words approach completely empties footnote 5 of any meaning.

Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

APPENDIX

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APPENDIX A — ORDER AND OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DATED AND FILED JUNE 7, 1999

FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LAWRENCE EPSTEIN; JOHN LINDER; JANE ROCKFORD, as trustee of the Michael J. Rockford Trust; MAURICE KARLIN; RUTH KARLIN; BETH ANN KARLIN; BERT P. KARLIN,

Plaintiffs-Appellants,

v.

MCA, INC.; MATSUSHITA ACQUISITION CORPORATION; MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD.; MATSUSHITA HOLDING CORPORATION; LEW WASSERMAN; SIDNEY J. SHEINBERG,

Defendants-Appellees.

No. 92-55675

D.C. No. CV-90-6451-R

ORDER AND OPINION

On Remand from the United States Supreme Court
Argued and Submitted
September 4, 1996—San Francisco, California
Opinion Filed October 22, 1997
Petition for Rehearing Granted June 8, 1998
Reargued and Resubmitted
August 21, 1998—San Francisco, California

Opinion Withdrawn June 7, 1999
Filed June 7, 1999

Before: Charles E. Wiggins, Diarmuid F. O'Scannlain, and Sidney R. Thomas, Circuit Judges.

Appendix A

Opinion by Judge O'Scannlain;
Concurrence by Judge Wiggins;
Dissent by Judge Thomas

SUMMARY

Securities/Class Actions

The court of appeals affirmed a judgment of the district court. On remand from the United States Supreme Court, the court held that in a class action by shareholders of a takeover target corporation alleging inequality of treatment among tendering shareholders, a state court judgment that determines the fairness of a settlement is entitled to full faith and credit when the judgment is based on procedures that satisfy due process requirements.

In 1990, appellee Matsushita Acquisition Corporation made a tender offer for appellee MCA, Inc. A class of Delaware shareholders brought claims in state court alleging that MCA's directors breached their fiduciary duties under Delaware law by failing to maximize shareholder value on a change in corporate control. While the Delaware action was pending, appellant Lawrence Epstein and other dissident shareholders filed a federal class action alleging that Matsushita's tender offer violated federal securities laws.

The district court refused to certify the Epstein group as a class, and granted summary judgment against them. While the Epstein group appealed, the Delaware class action settled. The judgment approving the settlement expressly provided for the release of the federal claims that were before the Ninth Circuit.

Noting that the Epstein appellants were members of both the state class and the proposed federal class and did not opt

out of the Delaware settlement, Matsushita contended before the Ninth Circuit that their federal claims were barred by the Delaware judgment under the Full Faith and Credit Act.

In *Epstein I*, the Ninth Circuit held that the Full Faith and Credit Act did not apply because the Delaware settlement released claims exclusively within the jurisdiction of the federal courts under the Securities Exchange Act. The Supreme Court granted certiorari to determine whether the Ninth Circuit could withhold full faith and credit from the Delaware judgment.

The Supreme Court reversed in *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), holding that the Ninth Circuit could not deny full faith and credit to the Delaware judgment. The Court concluded that the Delaware judgment was entitled to full faith and credit because (1) under Delaware law, the Epstein appellants were bound by the Delaware settlement; and (2) the grant of exclusive federal jurisdiction in § 27 of the Exchange Act did not partially repeal the Full Faith and Credit Act.

On remand, the Ninth Circuit held in *Epstein II* that the Delaware judgment was not entitled to full faith and credit because it violated due process in the inadequacy of the class representation. The panel reversed and remanded the action to the district court. However, a reconstituted panel granted Matsushita's petition for rehearing. On rehearing, the court of appeals withdrew its opinion in *Epstein II*.

[1] The first step of the analysis employed by the Supreme Court to determine whether the Delaware judgment could bar litigation of exclusively federal claims required the Court to look to the law of the rendering state to ascertain the effect of the judgment. **[2]** The Court reviewed Delaware law on the preclusive effect of settlement judgment, and concluded that a Delaware court would have afforded preclusive effect of the settlement judgment in this case. **[3]** Turning to the due pro-

cess requirements for binding absent class members, the Court [4] satisfied itself that they were met.

[5] *Matsushita* necessarily entailed a determination of whether the judgment was constitutionally infirm. If it were, the judgment could not be binding under Delaware law; nor could a federal court afford it full faith and credit. The Supreme Court's holding that under Delaware law the Epstein appellants were bound by the judgment was necessarily premised on the constitutional validity of the Delaware judgment.

[6] The Supreme Court's determination of the preclusive effect of the judgment under Delaware law did not leave open consideration on remand of the adequacy of representation. [7] The absent class members' due-process right to adequate representation is not protected by collateral review, but by the certifying court initially, and thereafter by appeal within the state system, and by direct review in the Supreme Court. [8] Limited collateral review would be appropriate to consider whether the procedures in the prior litigation afforded the party against whom the judgment is asserted a full and fair opportunity to litigate the claim or issue. However, this review would not include reconsideration of the merits.

Judge Wiggins concurred separately to explain why he changed his vote in the case.

Judge Thomas dissented, concluding that the majority inappropriately sanctioned a class settlement obtained without record evidence that the class representatives were even members of the class.

COUNSEL

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Appendix A

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ORDER

The opinion filed on October 22, 1997, and reported at 126 F.3d 1235 (9th Cir. 1997), is withdrawn, and the attached opinion filed in its place.

OPINION

O'SCANNLAIN, Circuit Judge:

We reconsider our decision in this case which is still before us on remand from the United States Supreme Court.

In 1992, the United States District Court for the Central District of California entered summary judgment against plaintiffs-appellants ("the Epstein appellants"). In *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) ("*Epstein I*"), we reversed the District Court, and held, among other rulings, that because it released exclusively federal claims, a Delaware state judgment was not entitled to full faith and credit. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996) ("*Matsushita*"), the Supreme Court reversed our decision in *Epstein I* and remanded for proceedings consistent with its opinion. On remand we again held, in *Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997) ("*Epstein II*"), that the Delaware state judgment was not entitled to full faith and credit. We thereafter granted defendants-appellees' ("Matsushita") petition for rehearing, and the case was rear-

gued. We now withdraw our previous opinion, *Epstein II*, and substitute this opinion for it in all respects.

I

In 1990, Matsushita made a tender offer for (and subsequently acquired) MCA, Inc. The tender offer precipitated two lawsuits. On September 26, 1990, a Delaware class brought claims in Delaware's Chancery Court asserting that MCA's directors breached their fiduciary duties to shareholders under Delaware law by failing to maximize shareholder value upon a change in corporate control. On December 3, 1990, while the Delaware class action was pending, the Epstein appellants filed this class action in federal district court asserting that Matsushita's tender offer violated Securities and Exchange Commission Rules 10b-3 and 14d-10 promulgated under the Securities Exchange Act of 1934 ("Exchange Act").

On April 16, 1992, after extensive proceedings, the District Court declined to certify the Epstein appellants as a class and entered summary judgment against them. *See* Second Amended Order, No. 90-6451 (C.D. Cal. filed April 16, 1992). On October 22, 1992, while the appeal of the District Court's decision was pending before us, the Delaware class action was settled. The order and final judgment of the Delaware Chancery Court approving the settlement explicitly provided for the release of the federal claims raised in this action. *See In re MCA, Inc. Shareholders Litig.*, 1993 WL 43024 (Del. Ch. Feb. 16, 1993). Because the Epstein appellants were members of both the state class and the proposed federal class and did not opt out of the Delaware settlement, Matsushita argued before us on appeal that the Epstein appellants' federal claims were barred by the Delaware judgment under the Full Faith and Credit Act, 28 U.S.C. § 1738.

In *Epstein I*, we rejected Matsushita's argument, and held that the Full Faith and Credit Act did not apply because the

Delaware settlement released claims exclusively within the jurisdiction of the federal courts. Addressing the merits, we reversed the district court's entry of summary judgment and denial of class certification.[1] The Supreme Court granted certiorari to decide whether this court could withhold full faith and credit from the Delaware state judgment releasing claims within the exclusive jurisdiction of the federal courts under the Exchange Act.

The Supreme Court held that we could not, concluding that the Delaware judgment was entitled to full faith and credit because (1) under Delaware law, the Epstein appellants were bound by the Delaware class settlement releasing the federal claims, and (2) the grant of exclusive federal jurisdiction in § 27 of the Exchange Act did not partially repeal the Full Faith and Credit Act. The Supreme Court therefore reversed our decision in *Epstein I* and remanded. *See Matsushita*, 516 U.S. at 387.

On remand, a divided panel in *Epstein II* held that despite the Court's holding in *Matsushita*, the Delaware judgment was not entitled to full faith and credit because it violated due process based on the inadequacy of the class representation. The panel therefore reversed and remanded for proceedings consistent with those portions of *Epstein I* that were not reversed by the Supreme Court.

On October 24, 1997, two days after the filing of *Epstein II*, Judge Norris, the author of both *Epstein I* and *Epstein II*, resigned from this court. Matsushita filed a petition for rehearing on November 5, 1997. On January 9, 1998, Judge Thomas was drawn to replace Judge Norris and the reconstituted panel granted the petition for rehearing on June 8, 1998. Following rehearing, we now withdraw our opinion in *Epstein*

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[1]We affirmed the dismissal of an aiding and abetting claim that was conceded by the Epstein appellants.

II and consider anew whether the Epstein appellants are bound by the Delaware judgment.

II

The Epstein appellants assert that, despite the Supreme Court's holding in *Matsushita*, we cannot accord full faith and credit to the Delaware judgment because it violated their due process rights to adequate representation in and judicial supervision of the Delaware proceedings. We are somewhat perplexed by this contention, because *Matsushita*'s holding was explicitly and implicitly premised upon the validity of the Delaware judgment. The Supreme Court stated in *Matsushita* that the Epstein appellant's were "bound . . . by the judgment," 516 U.S. at 379, and held that the exclusively federal claims released by that judgment were not exempted from full faith and credit, *see id.* at 385-87. It should go without saying that we are not free to ignore the Court's determinations in *Matsushita* by holding that the Epstein appellants are *not* bound by the judgment.

A

[1] In *Matsushita*, the Supreme Court commenced its analysis by quoting the Full Faith and Credit Act's mandate "that the 'judicial proceedings' of any State 'shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken.' " 516 U.S. at 373 (quoting 28 U.S.C. § 1738). Accordingly, the first step of the *Marrese* analysis employed by the Court to determine whether the Delaware judgment could bar the litigation of exclusively federal claims required the Court to "look to the law of the rendering State to ascertain the effect of the judgment." *Matsushita*, 516 U.S. at 375 (citing *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 381-382 (1985)).

[2] Following *Marrese*'s instructions, the Court reviewed Delaware law on the preclusive effect of settlement judg-

ments. The Court's canvas revealed that "[t]he Delaware Supreme Court has [ ] manifested its understanding that when the Court of Chancery approves a global release of claims, its settlement judgment should preclude on-going or future federal court litigation of any released claims." *Id.* at 377. The Court further noted that under Delaware law, a state court settlement of a class action could release or preclude claims only where that settlement was "determined to be fair and to have met all due process requirements." *Id.* at 377-78 (quoting *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (Del. Ch. 1991)). The Court then concluded that "a Delaware court would afford preclusive effect to the settlement judgment in this case." *Id.* at 378.

[3] The Epstein appellants make much of this conditional language, but it merely reflects that the Court had yet to satisfy itself that the proceedings in Delaware had met all the due process requirements for binding absent class members.[2] Turning to these due process requirements, the Court proceeded to march through Delaware Chancery Rule 23, which is, as the Court noted, "modeled on Federal Rule of Civil Procedure 23." *Id.* at 371.

The Court stated that:

> As required by Delaware Court of Chancery Rule 23, *see Prezant v. De Angelis*, 636 A.2d 915, 920 (1994), the Court of Chancery found, and the Delaware Supreme Court affirmed, that the settlement was "fair, reasonable and adequate and in the best interests of the . . . Settlement class" and that notice

[2]We further believe that the Court's conditional language here and elsewhere, *see Matsushita*, 516 U.S. at 380 (stating that "it *appears* that the settlement judgment would be res judicata under Delaware law") (emphasis added), reflects the Court's recognition that the Delaware Supreme Court is the ultimate authority on matters of Delaware law. *See, e.g., Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 413 n.7 (1984).

> to the class was "in full compliance with . . . the requirements of due process." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740 (Feb. 22, 1993) . . . . The Court of Chancery "further determined that the plaintiffs[,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *In re MCA, Inc. Shareholders Litigation*, supra, reprinted in App. to Pet. for Cert. 73a. *Cf. Phillips Petroleum Co.*, supra, at 812, 105 S. Ct., at 2974 (due process requires "that the named plaintiff at all times adequately represent the interests of the absent class members").

Id. at 378-79.

[4] Having satisfied itself that the due process requirements necessary to bind absent class members were met, the Court stated its conclusion:

> Respondents do not deny that, as shareholders of MCA's common stock, they were part of the plaintiff class and that they never opted out; *they are bound, then, by the judgment.*

Id. at 379 (emphasis added). There was nothing conditional about this holding. The Court then proceeded to the second step of the *Marrese* analysis.

B

[5] While the Court's explicit consideration in *Matsushita* of the due process requirements to bind absent class members admittedly did not include an express statement that the Delaware judgment in question did not violate due process, that conclusion was logically necessary to the Court's holding. In *Kremer v. Chemical Construction Corp.*, the Supreme Court made plain that "[a] State may not grant preclusive effect in

its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment." 456 U.S. 461, 482 (1982). Thus in *Matsushita*, any resolution of the preclusive effect to be afforded under Delaware law to the Delaware judgment necessarily entailed a determination of whether the judgment was "constitutionally infirm." If the judgment were constitutionally infirm, the judgment could not be binding under Delaware law, nor could a federal court accord it full faith and credit. The Supreme Court's holding in *Matsushita* that under Delaware law the Epstein appellants were "bound, then, by the judgment," *Matsushita*, 516 U.S. at 379, was thus necessarily premised upon the constitutional validity of the Delaware judgment.[3]

It is further worth noting that if, as the Epstein appellants contend, the Delaware judgment violated due process and was invalid, the Court would have had no reason to proceed to step two of the *Marrese* analysis. The Court stated that it would proceed to step two only "[i]f state law indicates that the particular claim or issue would be barred from litigation in a court of that state." *Id.* at 375. Delaware law would bar the federal claims at issue only if the state settlement was

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[3]The Epstein appellants themselves recognize and employ similar logic in their papers. Matsushita cited *Snider v. City Of Excelsior Springs, Missouri*, 154 F.3d 809 (8th Cir. 1998), as supplemental authority demonstrating that the broad collateral review sought by the Epstein appellants is also precluded by the *Rooker-Feldman* doctrine. In response, the Epstein appellants asserted that the Court's decision in *Matsushita* necessarily subsumed a determination that the *Rooker-Feldman* doctrine was inapplicable and federal jurisdiction existed, because *Rooker-Feldman* limits the subject matter jurisdiction of the lower federal courts and thus must be addressed prior to any discussion of preclusion law. (*See* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2.) In light of this argument, the Epstein appellants should similarly recognize that the Court's determination that they were bound by the Delaware judgment necessarily subsumed a determination that the Delaware judgment was constitutionally valid, because states cannot give preclusive effect to constitutionally infirm judgments.

"determined to be fair and to have met all due process requirements." *In re MCA, Inc. Shareholders Litig.*, 598 A.2d 687, 691 (1991). Thus, if the Delaware judgment had not met all due process requirements, the question decided by *Matsushita* would not have been reached, or even presented.[4]

In fact, if the Epstein appellants' contention that the Delaware judgment is constitutionally infirm were true, *Matsushita* would be an advisory opinion. The Court's holding would have answered the purely hypothetical question of the full faith and credit to be accorded a *valid* state judgment releasing exclusively federal claims within the Exchange Act, regardless of the fact that no such valid judgment was before the Court. We will not presume that the Court violated Article III by rendering an advisory opinion. *See, e.g., Mills v. Rogers*, 457 U.S. 291, 305 (1982) (declining to consider merely hypothetical issues in light of the prohibition against advisory opinions); *Flast v. Cohen*, 392 U.S. 83, 96 (1968) (noting the Article III prohibition against advisory opinions).

C

The Epstein appellants assert, however, that the opinion explicitly left the validity of the judgment open, pointing to statements by Justice Ginsburg in her dissent, and by the Court in footnote five. *See Matsushita*, 516 U.S. at 379 n.5. We are not persuaded.

[6] The Epstein appellants rely heavily on Justice Ginsburg's statement that because "the Ninth Circuit decided the case without reaching the due process check on the full faith

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[4]Again, this logic should be familiar to the Epstein appellants. Just as the Epstein appellants asserted that consideration of a court's jurisdiction under *Rooker-Feldman* is logically prior to consideration of preclusion law, (*see* Plaintiffs-Appellants' Rule 28(j) Submission of Sept. 15, 1998, at 1-2), consideration of the validity of a state judgment under step one of the *Marrese* analysis is logically prior to consideration under step two of whether an exception to full faith and credit exists.

and credit obligation, that inquiry remains open for consideration on remand." *Id.* at 389. This belief, however, was not shared by the majority.[5] As Justice Stevens stated in his dissent, he could "join neither [the Court's determination of Delaware preclusion law] nor the Court's judgment" because he agreed with Justice Ginsburg "that the Ninth Circuit remains free to consider whether Delaware courts fully and fairly litigated the adequacy of class representation." *Id.* at 387. This statement demonstrates that the Court's determination of the preclusive effect of the judgment under Delaware law did not leave consideration of the adequacy of representation open on remand.

Justice Ginsburg similarly stated that she concurred only "to the extent that [the Court's judgment] remands the case to the Ninth Circuit," because she objected to the Court's consideration of the content of Delaware preclusion law. *Matsushita*, 516 U.S. at 388. Thus her statement that the due process issue "remains open for consideration on remand," *id.* at 389, is properly viewed as part of her dissent, and has no bearing on whether *Matsushita*'s holding was premised on the validity of the Delaware judgment. Moreover, Justice Ginsburg dissented because she evidently believed that the Court should not have endeavored "to speak the first word on the content of Delaware preclusion law." *Id.* at 388. This statement confirms that the Court did determine the content of Delaware preclusion law, which necessarily included a determination of the judgment's constitutional validity. *See Kremer*, 456 U.S. at 482.

The Epstein appellants also rely on the Court's now famous footnote five, in which the Court declined to address the Epstein appellants' contention "that the settlement proceedings did not satisfy due process because the class was inade-

[5]Which had, as noted previously, seemingly just performed this "due process check" in considering the preclusive effect of the judgment under Delaware law.

quately represented." *Id.* at 379 n.5. They ignore, however, the fact that the Court's statements in footnote five were in reference to a due process challenge "[a] part [sic] from any discussion of Delaware law." *Id.* The footnote does not indicate that the Court had not considered *any* due process concerns, nor would any such reading of the footnote be tenable in the face of the Court's explicit contemplation of the due process requirements to bind absent class members under Delaware law. Nor does the footnote in any way indicate that the Delaware courts had not resolved the issue, or that this determination would not be binding upon the Epstein appellants. Instead, the footnote implies that this determination would be binding by stating that the Epstein appellants "make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.*

Moreover, that the Court declined to address a due process "claim . . . outside the scope of the question presented," *id.*, did not necessarily leave the due process issues the Epstein appellants seek to raise open on remand. While the Court may not have wished to analyze independently every due process challenge to the Delaware judgment available under *Kremer*, its statement in footnote five did not preclude the implicit resolution of such a challenge by the Court's opinion, particularly where the issue the Epstein appellants sought to raise was necessarily intertwined with the Court's holding and discussion of other issues.

We further note that where the Court leaves an issue open on remand, it often expressly states that it has done so. *See, e.g., United States v. O'Hagan*, 117 S. Ct. 2199, 2220 (1997) (stating that petitioner's "other arguments . . . remain open for consideration on remand"); *United States v. Lanier*, 117 S. Ct. 1219, 1228 n.7 (1997) ("We also leave consideration of other issues that may remain open to the Court of Appeals on remand."). Such express statements in the Court's opinions are obviously of far greater weight than a statement in dissent

such as Justice Ginsburg's, and are different in kind from the *Matsushita* majority's statement in footnote five merely declining independently to address the Epstein appellants' due process claim.

III

Apart from any statements in *Matsushita* that the Epstein appellants believe explicitly left open their due process objections on remand, the Epstein appellants assert that *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), and *Kremer* create a largely unfettered right to challenge collaterally the adequacy of representation in class actions.[6]

A

Shutts does not support the broad collateral review that the Epstein appellants seek. In *Shutts*, the Court identified various

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[6]We note that Delaware law provides no basis for the collateral review that the Epstein appellants seek. As the Court stated in *Matsushita*, "a Delaware court would afford preclusive effect to the settlement judgment in this case." 516 U.S. at 378. The Delaware Supreme Court has explained that under Delaware law:

> Class members . . . will, in all cases, have their interests protected by the requirement that their claims cannot be compromised without . . . a judicial determination that the Rule 23 criteria have been satisfied . . . . *Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23.* This protection will help insure that the final release sought by defendants in settlements is indeed final.

Prezant, 636 A.2d at 925-26 (emphasis added).

As noted by the Court in *Matsushita*, the Delaware Chancery Court made the requisite findings, *see* 516 U.S. at 378-79, thus under *Prezant*, Matsushita is protected from a collateral attack on the validity of the settlement. *See also Hynson v. Drummond Coal Co., Inc.*, 1997 WL 741507, 1-2 (Del. Ch. Nov. 24, 1997) (rejecting class members' attempt to collaterally attack a Delaware judgment on due process grounds under *Shutts*).

procedural safeguards that are necessary to bind absent class members, including notice, the opportunity to be heard, the opportunity to opt out, and adequate representation. 472 U.S. at 812. However, nowhere in *Shutts* did the Court state or imply that where the certifying court makes a determination of the adequacy of representation in accord with *Shutts*, this determination is subject to collateral review. *Shutts* in fact implies that such review is unwarranted by emphasizing that the certifying court is charged with protecting the interests of the absent class members. *See id.* at 809.

[7] Simply put, the absent class members' due process right to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court. *See, e.g., Grimes v. Vitalink Comm. Corp.*, 17 F.3d 1553, 1558 (3rd Cir. 1994) (refusing to allow absent class members collaterally to challenge adequacy of representation because the opportunity to challenge that determination by appeal to Delaware Supreme Court, and thereafter to the United States Supreme Court, "granted all the process that was due"); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33 (1st Cir. 1991) (holding that so long as procedural safeguards were employed, objections to the determinations of a certifying court had to be remedied on appeal to the state supreme court or the United States Supreme Court, and not by recourse to the "federal courts in the vain pursuit of back-door relief").

As the Court stated in *Hansberry v. Lee*, "there has been a failure of due process only in those cases where it cannot be said that *the procedure adopted*, fairly insures the protection of the interests of absent parties who are to be bound by it." 311 U.S. 32, 42 (1940) (emphasis added). Due process requires that an absent class member's right to adequate representation be protected by the adoption of the appropriate procedures by the certifying court and by the courts that

review its determinations; due process does not require collateral second-guessing of those determinations and that review.

B

Kremer does not indicate otherwise. As we have noted previously, *Kremer* held that neither state nor federal courts are required to give full faith and credit to a constitutionally infirm judgment. *See Kremer*, 456 U.S. at 482. The extent of collateral review is, however, limited.

[8] *Kremer* merely recognized that a judgment is not entitled to full faith and credit "if there is reason to doubt the quality, extensiveness, or fairness of *procedures* followed in prior litigation." *Id.* at 481 (quoting *Montana v. United States*, 440 U.S. 147, 164 n.11 (1979)) (emphasis added). Limited collateral review would be appropriate, therefore, to consider whether the procedures in the prior litigation afforded the party against whom the earlier judgment is asserted a "full and fair opportunity" to litigate the claim or issue. *Id.* at 480. This review would not, however, include reconsideration of the merits of the claim or issue, *see id.* at 483-85 (declining to reexamine the facts underlying or the merits of Kremer's claim, and instead examining the procedures provided), and such a challenge would most likely fail because "state proceedings need do no more than satisfy the minimum procedural requirements of the Fourteenth Amendment's Due Process Clause in order to qualify for the full faith and credit guaranteed by federal law." *Id.* at 481.

C

Matsushita itself indicates that broad collateral review of the adequacy of representation (or of the other due process requirements for binding absent class members) is not available. *Matsushita* made plain that class action judgments are accorded full faith and credit like other judgments:

> That the judgment at issue is the result of a class action, rather than a suit brought by an individual, does not undermine the initial applicability of § 1738. The judgment of a state court in a class action is plainly the product of a "judicial proceeding" within the meaning of § 1738. Therefore, a judgment entered in a class action, like any other judgment entered in a state judicial proceeding, is presumptively entitled to full faith and credit under the express terms of the Act.

Matsushita, 516 U.S. at 373-74 (citations omitted).

The Court did, of course, address the additional due process requirements for binding absent class members, stating, by way of example, that "due process for class action plaintiffs requires 'notice plus an opportunity to be heard and participate in the litigation,' " and " 'that the named plaintiff at all times adequately represent the interests of the absent class members.' " *Id.* at 378-79 (quoting *Shutts*, 472 U.S. at 812). The Court, however, satisfied itself that these requirements had been met *by referencing the Delaware courts' findings on these matters*, rather than by independently determining whether the requirements were met. *See id.*[7]

After this analysis, the Court stated the seemingly uncontroversial proposition that:

> Under Delaware Rule 23, as under Federal Rule of Civil Procedure 23, "[a]ll members of the class, whether of a plaintiff or a defendant class, are bound by the judgment entered in the action unless, in a Rule 23(b)(3) action, they make a timely election for

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[7]We further note that the Court's citation of *Shutts*, immediately after referencing the findings of the Delaware courts' regarding the due process requirements, belies the Epstein appellants' assertion that *Shutts* supports collateral review of these determinations.

> exclusion." 2 H. Newberg, *Class Actions* § 2755, p. 1224 (1977).

Id. at 379. The Court also cited *Cooper v. Federal Reserve Bank of Richmond* for the proposition that "[t]here is of course no dispute that under elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation." 467 U.S. 867, 874 (1984).

The Court's statements in no way imply that a class member who fails to opt out is not bound until collateral review of the adequacy of representation reveals that due process has been satisfied. Nor is there any indication that a "properly entertained" class action is other than one in which a certifying court employs the appropriate procedures to determine that the due process requirements embodied in Rule 23 have been met. Any such implication would be belied by the Court's analysis of the issue because these statements followed on the heels of the Court's review of the Delaware courts' determinations that the Rule 23 requirements were satisfied.

Even footnote five, so heavily relied upon by the Epstein appellants, makes the same point. There, the Court specifically noted that the Epstein appellants sought to challenge collaterally the adequacy of representation "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Matsushita*, 516 U.S. at 379 n.5. The Court then cited *Prezant v. De Angelis* for the proposition that the "constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4)." *Id.* (alterations in the original). These statements indicated that the Epstein appellants' challenge to the adequacy of representation in the Delaware proceedings was answered by specific reference to the findings made on the issue in those proceedings.

Appendix A

IV

For the foregoing reasons, the Delaware judgment was not constitutionally infirm and must be accorded full faith and credit. The district court's decision of April 16, 1992 is

AFFIRMED.

WIGGINS, Circuit Judge, concurring:

I concur in the result of Judge O'Scannlain's majority opinion. I write separately to explain why I changed my vote in this appeal.

The long history of this case evinces the complexity of the issues involved. In our original disposition, we found that the Delaware judgment was not a bar to further prosecution of the federal action under the Full Faith and Credit Act, 28 U.S.C. § 1738. *See Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995). The Supreme Court reversed, concluding that the Delaware judgment was entitled to full faith and credit even if it released claims within the exclusive jurisdiction of the federal courts. *See Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367 (1996)("*Matsushita*"). Following remand, we were presented with the issue that is the subject of this appeal.

After our initial consideration of this appeal, I joined Judge Norris' well-written opinion. *See Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997). We found that the adequacy of representation issue was left open by the Supreme Court and was not fully and fairly litigated in state court. *See id.* at 1237-48. Proceeding to the merits of the adequacy of representation issue, the opinion convincingly concluded that Delaware counsel provided inadequate representation: "This was not merely 'inadequate' representation, it was hostile representation that served the interests of counsel in getting a fee, but

did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims." *Id.* at 1255.

I remain troubled by the substance of the Delaware settlement. Soon after the opinion was filed, however, I began to have grave doubts about the conclusion that the adequacy of representation issue was not fully and fairly litigated in the Delaware courts. It is this issue that led me to change my vote.

I now believe that, while the Supreme Court did not conclusively resolve the due process issue before the remand, it did send unmistakable signals on that very issue. In three separate passages, the Court indicated that the Delaware courts likely had already conclusively resolved the due process issue.[1] Our original majority disposition in this appeal did not give sufficient weight to these admonitions.

The Supreme Court's conclusion is clearly supported by the record. One of the objectors, William Krupman, explicitly opposed the proposed settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate*

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[1]First, in Part I of it opinion, as it described the procedural posture of the case it stated that "[a]fter argument from several objectors, the [Chancery] court found the class representation adequate . . . ." *Matsushita*, 516 U.S. at 371. Later, in explaining why it believed that the Delaware courts would afford preclusive effect to the settlement judgment, the Supreme Court explained that "[t]he Court of Chancery 'further determined that the plaintiffs[,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *Id.* at 378 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del.Ch. Feb. 22, 1993))(internal quotation marks omitted). Finally, the Court expressed its astonishment at plaintiffs' decision to assert their due process claim "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Id.* at 379 n.5.

representation to the class." Affidavit of William A Krupman at 2-3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993) (emphasis added). In considering Krupman's objection, the Chancery Court felt that his objection concerning the adequacy of the class representatives' representation of the class members was similar to the objection raised by another objector, Pamela Minton de Ruiz, who objected to the settlement "on the basis that the settlement is collusive." *In re MCA, Inc. Shareholders Litig.* 1993 WL 43024 *3. The Chancery Court nonetheless approved the settlement because the settlement was "in the best interest of the class," notwithstanding these objections to the adequacy of the class representatives' representation. *Id.*

Because the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Chancery Court, the Delaware courts would give preclusive effect to that determination. *See Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del. 1995). The Full Faith and Credit Act, 28 U.S.C. § 1738, requires that we "treat a state court judgment with the same respect that it would receive in the courts of the rendering state." *Matsushita*, 516 U.S. at 373. As such, we are required to give preclusive effect to the Chancery Court's judgment that class representation was adequate irrespective of whether we agree with that determination. I therefore concur.

THOMAS, Circuit Judge, dissenting:

Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997) heralded a new era of judicial scrutiny of class action certification and settlement. The majority opinion marks a significant retreat from that philosophy, sanctioning a class settlement obtained without any record evidence that the class representatives were even members of the class. Because the Delaware judgment extinguished the rights of absent class members

without affording them due process of law, I respectfully dissent.[1]

I

Before hedging its bet by reaching the merits, the majority first concludes that we are precluded from deciding the due process questions presented to us because the Supreme Court has already done so. The opening passage of *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996) belies this:

> This case presents a question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Id. at 369.

The Court further explained:

> We need not address the due process claim [of inadequate representation] . . . because it is outside the scope of the question presented in this Court. *See Yee v. Escondido*, 503 U.S. 519, 533 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights Medical Center*, Inc. 485 U.S. 80, 86 (1988).

Id. at 379, n.5 (1996).

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[1]Insofar as is possible, I shall not repeat Judge Norris's forceful analysis, as detailed in the panel opinion on remand. *See Epstein v. MCA, Inc.*, 126 F.3d 1235 (9th Cir. 1997). It demands an independent and careful examination and is, in my view, dispositive.

If the majority's recognition of the scope of its holding were not already plain, Justice Ginsburg's partial concurrence makes it pellucid:

> Although the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand.

Id. at 389.

The nuances that the majority strains to draw from the opinion simply cannot bear the weight placed on them. There is nothing in the opinion that relieves us of our responsibility to examine the merits of the due process argument fully and fairly. Indeed, if any unmistakable signal were sent by the opinion, it was to do just that.

II

Judgments binding absent litigants in class action suits are an exception to the general rule that one is not bound by a judgment in personam in a litigation to which he or she is not a party. *See Hansberry v. Lee*, 311 U.S. 32, 40-41 (1940). Absent class members may be bound by the judgment if they have, in fact, been adequately represented by parties who are present. *Id.* at 42-43. Due process requires that the procedure employed to reach a binding judgment "fairly insures the protection of the interests of absent parties who are to be bound by it." *Id.* at 42.

This is, in the words of the *Hansberry* court almost sixty years ago, a "familiar doctrine." *Id.* Yet its import seems lost in this case. In order for absent class members to have "adequate representation" within the meaning of the Due Process Clause, the class must be free of structural conflict. Although analyzed in the context of Fed. R. Civ. P. 23, this proposition was central to the seminal analysis in *Amchem*.

521 U.S. at 625-628. In a class settlement, there must be "structural assurance of fair and adequate representation for the diverse groups and individuals affected." *Id.* at 627. The class representative "must possess the same interest and suffer the same injury shared by all members of the class he represents." *Schlesinger v. Reservists to Stop the War*, 418 U.S. 208, 216 (1974).

In the case at hand, there were three different types of shareholders who were part of the class: (a) those who traded on the open market; (b) those who tendered their shares; and (c) those who received spin-off shares. In addition, there were differences among the class members as to the legal theories available. The interests of the Epstein plaintiffs in advancing the federal claims were directly antagonistic to those of the Delaware class representatives, who were precluded by federal securities law from asserting those claims in state court. By the time settlement occurred, the statute of limitations prevented the Delaware class from litigating the federal claims in any court. Thus, there were irreconcilable differences in claims and damages among the class members. These structural conflicts should have actuated an inquiry by the Delaware Vice-Chancellor, and should have resulted in the creation of sub-classes to assure the adequate representation of absent class members.

The conflict prior to settlement approval was palpable. Because they could not assert federal causes of action, those claims were of no value to the class representatives and their counsel except as a bargaining chip to enhance the value of their state claims. Indeed, settlement of the federal action was the only method by which the Delaware class could receive any money from the federal claims. Thus, it was plainly in the best interest of class representatives to settle the federal claims at any price. Class representatives had absolutely no incentive to obtain fair valuation of the federal claims, because of their inability to assert the claims.

The divergence of class interests quickly manifested itself. While Delaware counsel was admitting to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" and in the complete absence of discovery, before concluding that the claim was "frivolous," the MCA shareholders were extensively litigating that very claim in federal district court in this Circuit. And while the Delaware counsel was arguing before the Chancery Court that the Ninth Circuit was "unlikely" to overturn the district court's dismissal of the Wasserman claim, the MCA shareholders were in the process of successfully appealing that decision before this court. In addition to the inadequate representation of the Wasserman issue, it is also noteworthy that there is not a single mention of the $21 million payment to Sheinberg in the Delaware counsel's memoranda or arguments to the Chancery Court, although it is clear that Delaware counsel was aware of this claim, which had a potential value of $17.80 per share.

"[A]dequate representation . . . depends on . . . an absence of antagonism." *Brown v. Ticor Title Insurance Co.*, 982 F.2d 386, 390 (9th Cir. 1992). In this case, the antagonistic interests, injury and claims among the class members resulted in significant structural conflicts. Because these conflicts were unresolved, the class representation was constitutionally infirm and cannot bind absent class members.

In addition, the actual representation provided by Delaware class counsel was inadequate for reasons persuasively detailed in Judge Norris's opinion on remand. *See Epstein*, 126 F.3d at 1251-55. Class counsel did not investigate or properly evaluate the federal claims. Class counsel provided a misleading and incorrect analysis of the claims to the Chancery Court. The interests of the Epstein plaintiffs were not represented adequately by class counsel; indeed, their interests were undermined by the antagonistic strategy of class counsel.

Finally, there is no record evidence that the class representatives were even members of the putative class. A non-

waivable prerequisite to approval of a class settlement binding absent class members is that the class representative be a member of the class. *See East Motor Freight System, Inc. v. Rodriquez*, 431 U.S. 395, 403 (1977) ("As this Court has repeatedly held, a class representative must be part of the class . . . ."). The best argument that the class representatives could offer was that such an allegation was contained in the complaint, that there were a large number of law firms involved and that the settlement was accepted by class members.[2] None of this, of course, comes close to being record evidence. This explanation can be credited only if one believes that representational adequacy or adherence to procedural due process may be established by circumstantial evidence.

The majority decision correctly observes that *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), enumerated "various procedural safeguards that are necessary to bind

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[2]The class representatives did not reply to this charge in their briefs. At oral argument, the following colloquy occurred:

> "Question: Where is there evidence in the record that any of the named representatives were actually members of the class?
>
> Answer: In the Delaware proceeding, there were twelve different class representatives, represented by twenty different law firms and all of them were possessed of the state and federal claims that were resolved in the Delaware action.
>
> Question: Is your answer basically that there is nothing of evidence in the record, but everyone was on notice and you are relying on that?
>
> Answer: I'm certainly relying on the fact that a notice went to every single class member outlining the settlement, the pendency of the federal action, the pendency of state action, what each class member would receive and what each member would forfeit, and I'm relying on the fact that the settlement proceeds which were accepted by all class members, including the Epstein plaintiffs, were only paid to shareholders who tendered pursuant to the tender offer and I'm relying on the fact that the Delaware complaint was brought on behalf of all MCA shareholders."

absent class members." In fact, *Shutts* specifically indicates that "the Due Process Clause of course requires that the named plaintiff at all times adequately represents the interests of the absent class members." 472 U.S. at 812 (*citing Hansberry v. Lee*, 311 U.S. 32, 42-43 (1940)). The litigation leading up to the Delaware settlement thus violated the "minimal procedural due process protection" due to the Epstein plaintiffs: adequate representation "at all times."

"[I]f the plaintiff was not adequately represented in the prior action, or there was a denial of due process, then the prior decision has no preclusive effect." *Brown*, 982 F.2d at 386. Thus, the Epstein plaintiffs are entitled as a matter of federal law to assert their claims in this action.

III

In addition to federal due process concerns, the Delaware Supreme Court's own interpretation of Delaware Chancery Courts Rule 23, as articulated in *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), requires us to address the Epstein plaintiffs' collateral attack of this settlement on the grounds of inadequate representation. Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment actually has been litigated and determined by a valid and final judgment. *Messick v. Star Enterprise*, 655 A.2d 1209, 1211 (Del. 1995); *Orange Bowl Corp. v. Jones*, 1986 WL 13095, at *2 (Del. Super. 1986); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at *2 (Del. Super. 1986). The Delaware record shows that the issue of adequacy of representation was not litigated during the settlement proceedings.

The notice to the class members regarding the settlement hearing did not indicate that the issue of adequacy of representation, either by class representative or by class counsel, would be addressed.

Perhaps as a consequence of the absence of notice, the four objectors who participated in the Delaware proceedings did

not litigate the question of the adequacy of representation. In addressing the concerns that were litigated by the objectors, the Delaware Chancery Court first determined that the fact that few small shareholders would actually opt out of the settlement, as was their right, did not undermine the validity of the settlement agreement. *In re MCA, Inc. Shareholders' Litigation*, 1993 WL 43024, at *4. Second, it determined that it did not need to await the Ninth Circuit's appellate decision in the *Epstein* matter in order to approve the settlement. *Id.* at *5. Third, the Chancery Court concluded that those shareholders who received delayed notice had assumed the risk of such delays in holding their shares under a "street name." *Id.* And finally, it determined that there was insufficient evidence to support the objectors' claim that the agreement was a collusive means of obtaining settlement of the federal claims. *Id.*

Of these four explicit findings, it is clear that only the second and fourth claim are even tangentially relevant to the claims raised by the Epstein plaintiffs before this court today. The second finding indicated that the valuation of the state claims were not dependant upon the resolution of the federal matter. But the Chancery Court did not assert that the plaintiffs raising the federal claims were adequately represented in the Delaware action. The fourth finding simply makes clear the fact that there was no collusive settlement "deal" between the plaintiffs and attorneys on both sides of the state court matter. The fact that there was no finding of wrongdoing certainly does not preclude a finding that the federal plaintiffs were inadequately represented by the settling class.

In short, none of the Chancery Court's findings address the claim of the plaintiffs before this court today: namely, that the federal plaintiffs were inadequately represented before the Delaware court, and that, consequently, a decision to bind them to the terms of the settlement would violate their rights to due process.

The Epstein plaintiffs correctly argue that to be bound by the settlement decision they are entitled under Delaware law

to specific findings that they were adequately represented in the Delaware Chancery Court. Such findings are required in order to bind the federal litigants to the settlement terms. In *Prezant*, 636 A.2d at 924, the Delaware Supreme Court explicitly held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning." Yet the statement offered by the Delaware Chancery Court asserting that the plaintiffs in the action "fairly and adequately protected the interests of the Settlement Class" offers no "supporting reasoning" aside from that offered to address the challenges raised by the four objectors. No findings exist in the Chancery Court's decision that would indicate that the representation of the absent federal plaintiffs was adequate, because the matter was never actually litigated before that court.

Thus, while the Supreme Court decision in *Matsushita* makes it clear that the objectors will be bound by the judgment of the Delaware court with respect to the matters litigated,[3] the Delaware court's decision cannot be read to bind those whose claims were simply never represented before it. The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absent class members to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing could therefore not bind other parties with respect to the issue of adequacy of representation.[4] Thus, the majority's determination today also runs against the settled law of Delaware.

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[3]Thus, interpreting the *Matsushita* decision to leave the Epstein plaintiffs' due process claim open for determination on remand does not, as the majority contends, render *Matsushita* an "advisory decision." On the contrary, the Court's decision makes it clear that all participants in the Delaware action will be bound by the judgment in spite of the exclusively federal nature of any claims they sought to raise elsewhere.

[4]This conclusion does not undermine the finality of a class action settlement to any degree greater than that already permissible under the law. In *Prezant*, the Delaware Supreme Court pointed out that prudent class action defendants can foreclose subsequent collateral action absolutely by asking for a judicial finding, supported through reasoning and evidence, that all plaintiffs' "due process right to adequate representation has been satisfied." 636 A.2d at 925-26. Such a finding simply was not made in this case.

Appendix A

IV

Providing the Epstein plaintiffs with the opportunity to raise their due process claims does not, as the majority claims, result in the "collateral second guessing" of the determinations and review of the Delaware courts. Those determinations are valid, and, to the extent that they comply with due process protections afforded by the Constitution, they are binding upon this court. Thus, the result originally reached by the panel on remand was not violative of cooperative federalism or comity. The majority today gives license to those who would run to a favorable and remote state court to obtain settlements premised on bargain-basement valuations of federal claims, even when those claims clearly predominate over potential state causes of action. This result must be especially discouraging to responsible law firms specializing in class action suits, who assiduously and carefully construct subclasses to assure adequate representation of diverse interests, even at the expense of their own fees.

The Epstein plaintiffs seek to raise claims that received neither determination nor review in the Delaware courts. Structural conflicts of interest precluded adequate representation of absent class members. The Epstein plaintiffs were not adequately represented in the Delaware state court proceedings by either the class representatives or the objectors, and their claim was never litigated in Delaware state court. In denying them the right to bring their meritorious federal claims before us, we deny them due process of law. We also significantly diminish the proper oversight role of the judiciary over class action settlements.

I respectfully dissent.

APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DATED AND FILED OCTOBER 22, 1997

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 92-55675

D.C. No. CV-90-6451-R

LAWRENCE EPSTEIN; JOHN LINDER; JANE ROCKFORD, as trustee of the Michael J. Rockford Trust; MAURICE KARLIN; RUTH KARLIN; BETH ANN KARLIN; BERT P. KARLIN,

Plaintiffs – Appellants,

v.

MCA, INC.; MATSUSHITA ACQUISITION CORPORATION; MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD; MATSUSHITA HOLDING CORPORATION; LEW WASSERMAN; SIDNEY J. SHEINBERG,

Defendants – Appellees.

OPINION

On Remand from the United States Supreme Court
Argued and Submitted September 4, 1996
San Francisco, California
Filed October 22, 1997

Appendix B

Before: NORRIS, WIGGINS, and O'SCANNLAIN, Circuit Judges.

NORRIS, Circuit Judge:

This case is before us on remand from the United States Supreme Court. In *Matsushita Electric Industrial Co. v. Epstein*, 116 S. Ct. 873 (1996) ("*Matsushita*"), the Court reversed our judgment in *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) ("*Epstein I*"), and remanded "for proceedings consistent with this opinion." *Matsushita*, 116 S. Ct. at 884.

The case is a class action brought by former MCA shareholders who surrendered their stock in response to a tender offer by Matsushita. In *Epstein I*, the named plaintiffs ("the Epstein plaintiffs") contended, *inter alia*, that Matsushita's tender offer violated the so-called "all-holder, best-price" rule of SEC Rule 14d-10[1] by paying a premium for the stock of MCA's chairman and chief executive officer, Lew Wasserman, and MCA's chief operating officer, Sidney Sheinberg.[2] The district court awarded summary judgment to the defendants, and the Epstein plaintiffs appealed.

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1. Rule 14d-10, 17 C.F.R. § 240.14d-10 (1994), is promulgated under Section 14(d)(7) of the 1968 Williams Act Amendments [hereinafter "The Williams Act"] to the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d)(6)-(7) (1994) [hereinafter "The Exchange Act"].

2. The Epstein plaintiffs also claimed that the premiums paid to Messrs. Wasserman and Sheinberg violated SEC Rule 10b-13, 17 C.F.R. § 240.10b-13 (1994). We did not consider the Rule 10b-13 claim in *Epstein I* because any relief that the Epstein plaintiffs could have obtained under Rule 10b-13 was also available under Rule 14d-10. *See Epstein I*, 50 F.3d at 648 n.5.

Appendix B

In *Epstein I* we reversed the summary judgment for Matsushita, holding that its agreement to purchase Mr. Wasserman's stock for consideration different from what it offered other shareholders violated Rule 14d-10, *see Epstein I*, 50 F.3d at 653-57, and that there was a material issue of fact as to whether a $21-million dollar payment to Mr. Sheinberg was legitimately made as incentive compensation for past services or was a premium for his stock paid in violation of Rule 14d-10. *See id.* at 657-59. We rejected Matushita's argument that there was no private right of action under § 14(d)(7) of the Williams Act, following the decisions of the Second and Third Circuits on that point.[3] *See id.* at 649-52. We also rejected Matsushita's argument that its purchase of Mr. Wasserman's stock could not have violated Rule 14d-10 because his stock was not exchanged until one hour after Matsushita accepted the tendered MCA shares for payment. *See id.* at 654-57. We also held that the district court had abused its discretion in refusing to certify the class because "[t]he claims of every tendering shareholder turn on identical facts and law — regardless of the identity or circumstances of the particular shareholder." *Id.* at 668. Finally, we affirmed the district court's dismissal of the "aiding and abetting" claims against MCA and Messrs. Wasserman and Sheinberg personally in light of the Epstein plaintiffs' concession on the issue. *See id.* at 665 n.29.

None of these rulings on the merits of the Rule 14d-10 claims were disturbed by the Supreme Court in *Matsushita*. The Court reversed our judgment and remanded for further

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3. *See Polaroid Corp. v. Disney*, 862 F.2d 987, 996 (3d Cir. 1988); *Field v. Trump*, 850 F.2d 938, 946 (2d Cir. 1988).

proceedings solely on the basis of the first question presented in Matsushita's petition for the writ of certiorari: "Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement released exclusively federal claims."[4] *Matsushita Electric Indus. Co. v. Epstein*, 115 S. Ct. 2576 (1995) (granting certiorari limited to Question 1 presented by the petition for writ of certiorari); *see also Matsushita*, 116 S. Ct. at 884 (remand order).

On remand, the Epstein plaintiffs press anew an argument that we found unnecessary to address in *Epstein I*: that we should withhold full faith and credit from the Delaware judgment because it was entered into in violation of the due process right of the absent class members to adequate representation at all times. We now turn to that question.

I

Matsushita contends that we are barred from addressing the merits of the Epstein plaintiffs' claims of inadequate representation. Matsushita makes three arguments in support of this contention:

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4. The Supreme Court accepted Matsushita's statement of the question presented even though that statement mischaracterized our holding. We did not withhold full faith and credit "simply" because the Delaware judgment released exclusively federal claims. Rather, we withheld full faith and credit because the great disparity between the state and federal claims — there were no overlapping issues of fact whatsoever (*see Epstein I* at 665-66) — meant that a judgment based upon an adjudication of the state claims could have no issue preclusive effect on the federal claims.

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(1) The Supreme Court's decision in *Matsushita* did not leave the issue open on remand;

(2) The issue of the adequacy of representation was fully and fairly litigated in the Delaware Court of Chancery;

(3) The Epstein plaintiffs are estopped from raising the adequacy of their representation collaterally because they did not raise it by intervening in the Delaware proceeding.

A

In arguing that the "[t]he opinion of the Supreme Court leaves no issue open on remand," Appellees' Br. at 1, Matsushita either mischaracterizes or disregards the unambiguous statements in the record to the contrary:

1. Matsushita fails to cite the Court's order granting certiorari, which limited the question it would review to Question 1 in Matsushita's petition. *See Matsushita Electric Industrial Co. v. Epstein*, 115 S. Ct. 2576 (1995); *see also Matsushita*, Pet. for Cert., at i ("1. Whether a federal court can withhold full faith and credit from a state court final judgment approving a class action settlement simply because the settlement includes a release of exclusively federal claims.").

2. Matsushita fails to include the first sentence of the Court's opinion which limited the question presented precisely the way Matsushita stated it in its petition for certiorari:

> This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts.

Matsushita, 116 S. Ct. at 875-76.

3. Matsushita, although quoting various excerpts from the Court's opinion, fails to quote the following explicit statement by the Court that it did not address the due process claim:

> We need not address the due process claim [of inadequate representation] . . . because it is outside the scope of the question presented in this Court. *See Yee v. Escondido*, 503 U.S. 519, 533, 112 S. Ct. 1522, 1531, 118 L.Ed.2d 153 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80, 86, 108 S. Ct. 896, 899, 99 L.Ed.2d 75 (1988).

Id. at 880, n.5.

4. Matsushita also fails to cite the explicit statement in Justice Ginsburg's separate opinion that the due process question of adequate representation remained open on remand, a statement that went unchallenged by any member of the Court:

> Mindful that this is a court of final review and not first view, I do not address the merits of the Epstein plaintiffs' contentions [regarding the adequacy of representation], or Matsushita's counterargument that the issue of adequate representation was resolved by full and fair litigation in the Delaware Court of Chancery. *These arguments remain open for airing on remand.*

Id. at 890 (Ginsburg, J., concurring in part and dissenting in part) (emphasis added).

5. Finally, in arguing that the due process question is not open on remand, Matsushita ignores its *own* assertions to the Court that the question was not before it for decision. In their brief, the Epstein plaintiffs invited the Court to address the adequacy of representation issue, notwithstanding that it was outside the scope of the sole question on which the Court had granted certiorari. *See Matsushita* Resp. Br. at 34-45. In its Reply Brief, Matsushita responded:

> A. The Ninth Circuit Opinion is Not Predicated Upon Any Due Process Issue.
>
> Respondents invite this Court to find constitutional infirmity in the Delaware proceedings based on alleged inadequate representation and judicial supervision. Resp. Br. at 34-45. As respondents concede, the Ninth Circuit's holding is *not* predicated on these fact-

> specific issues. Resp. Br. at 8. Accordingly, this Court should decline to address them.

Matsushita Reply Br. at 13.

Given this state of the record, we must agree with the Epstein plaintiffs that Matsushita's argument that the due process question is not open on remand is "inexplicable." Reply Br. at 4. Matsushita attaches no weight to the Supreme Court's clear disclaimer that "We need not address the due process claim," *Matsushita*, 116 S. Ct. at 880, n.5., and all the other references in the record that reaffirm this disclaimer.

Instead, Matsushita attempts to get around the Court's unambiguous disclaimer. First, it seizes upon language in the Court's opinion concerning Delaware preclusion law and lifts it out of context. "State-court approval of the settlement would have the collateral effect of preventing class members from prosecuting their claims in federal court." *Matsushita*, 116 S. Ct. at 879; *accord* Appellees' Br. at 12. While an accurate summary of the Supreme Court's reading of Delaware preclusion law, this passage lends no support to the argument that the Supreme Court addressed, let alone disposed of, the Epstein plaintiffs' inadequate representation claim.

Matsushita's position that the Court in *Matsushita* *implicitly* held that the Delaware proceeding satisfied due process reads volumes between the lines. When taken in the face of the Court's explicit announcement that it did *not* render such a holding, we agree with the Epstein plaintiffs that it becomes nothing less than "incomprehensible." Appellants' Br. at 5.

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Matsushita's second ground for arguing that adequacy of representation is not open on remand rests on the very footnote — from which it selectively excerpts — in which the Court expressly stated that it was *not* addressing due process. Matsushita misleading quotes only the first part of the footnote, which reads as follows:

> A part [sic] from any discussion of Delaware law, respondents contend that the settlement proceeding did not satisfy due process because the class was inadequately represented. . . . Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class. . . .

Id. at 880, n.5 (citations omitted). Matsushita omits the very next sentence of the footnote, however, in which the Court made clear that it was not disposing of the due process claim.

> We need not address the due process claim, however, because it is outside the scope of the question presented in this Court.

Id.

Matsushita would have us believe that the Court was "winking" at us — saying that it was not doing exactly what it was doing. The only reasonable interpretation of these sentences, however, is that the Court was simply stating the claim of the Epstein plaintiffs that their representation in the Delaware proceeding was constitutionally inadequate.

In sum, we reject Matsushita's argument that the Supreme Court did not leave the due process issue open on remand. The Court laid out an unambiguous contrary intention in its statement of the question presented and in footnote five, and no voice was raised against Justice Ginsburg's explicit statement that the issue of adequacy of representation "remain[ed] open for airing on remand." *Id.* at 890 (Ginsburg, J., concurring in part and dissenting in part).

B

Next we address Matsushita's argument that the Delaware settlement judgment precludes the Epstein plaintiffs from "relitigating" the issue of adequacy of representation under Delaware issue preclusion law. It claims that adequacy of representation was actually litigated by objectors at the Delaware fairness hearing, and that other Delaware courts would therefore give preclusive effect to the Chancery Court's determination that representation of the absent class members was adequate. Appellees' Br. at 16-18, 21-24, 22 n.6. Therefore, Matsushita argues, under 28 U.S.C. § 1738, we too must attach issue preclusion. *See id.* at 23.

The Epstein plaintiffs argue in response that the Delaware judgment raises no issue preclusion bar to the question of constitutional adequacy of representation. First, they contend, the objectors did not actually litigate the issue at the Delaware fairness hearing, as is required under Delaware issue preclusion law. *See* Appellants' Br. at 21-23; Reply Br. at 10. More broadly, the Epstein plaintiffs

contend that individual, uncertified objectors in a class action cannot constitutionally bind absent class members on the issue of adequacy of representation. *See id.* at 17-18. We consider each contention in turn.

1

Under Delaware law, issue preclusion attaches only when a question of fact essential to the judgment has been actually litigated and determined by a valid and final judgment. *See Messick v. Star Enterprise*, 655 A.2d 1209, 1211 (Del. 1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment.") (internal quotations omitted) (emphasis added); *Orange Bowl Corp. v. Jones*, 1986 WL 13095, at * 2 (Del. Super. 1986); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at * 2 (Del. Super. 1986). The Delaware record shows clearly that the issue of adequacy of representation was not litigated during the settlement proceedings.

First, the notice to class members said nothing about adequacy of representation. Instead, the notice stated that the purpose of the settlement hearing was to determine "(a) the fairness, reasonableness, and adequacy *of the terms of the . . . Settlement*, and (b) whether an order and final judgment should be entered approving the proposed settlement." Supplemental Record ("SR") 354 (emphasis added). Whether the class was adequately represented by the named plaintiffs or by class counsel was not an issue noticed for hearing. Thus, absent class members were not on notice that they could have objected to the adequacy of representation at the settlement hearing.

Not surprisingly, the objectors who did appear at the settlement hearing did not litigate the adequacy of their representation. Objector Marion Minton focused solely on the issue of inadequate notice. *See* SR 375. Objector Pamela Minton de Ruiz, in her memorandum to the Chancery Court, framed her objection in terms of collusion, arguing that "[t]he second proposed settlement is collusive and should not be approved." SR 402. Likewise, the Minton objectors argued at the settlement hearing that "this two-cent settlement is collusive." SR 574. Neither of the Minton objectors focused on the much broader issue of whether representation was constitutionally adequate. *See* SR 402-09.[5] Finally, objector William A. Krupman did submit an affidavit to the Chancery Court stating that he opposed the settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. They did not provide adequate representation." SR 422-23. However, this single blanket statement conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation hardly qualifies as "actual litigation" of the constitutional issue. Indeed, in his argument at the settlement hearing, objector Krupman did not address the constitutional adequacy of the representation, but argued only that the terms of the settlement were unfair. *See* SR 589-91.

Since the issue of adequacy of representation was never actually litigated in Chancery Court, no Delaware court

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5. Since the Chancery Court could have found that representation was inadequate without also finding that it was collusive, litigation of the collusion issue would not constitute "actual litigation" of adequacy of representation.

would attach preclusion to the issue of adequate representation of the absent class members. *See Star Enterprise*, 655 A.2d at 1211. Under § 1738, neither may we. *See, e.g., Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 88 (1984) (White, J., concurring) (collecting cases).[6]

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Even if adequacy of representation had actually been litigated by objectors at the fairness hearing, and even if Delaware law would allow an individual objector to bind an absentee on the issue of adequacy of representation — however improbable that might seem — we still could not

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6. It also appears that Delaware courts would not attach preclusion to the Delaware judgment because the Vice Chancellor failed to make a finding, supported by reasons and evidence on the record, that the requirements of Delaware Rule 23 were satisfied. In *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), the Delaware Supreme Court held that a Court of Chancery is required to "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning" before it approves a class action settlement. *Id.* at 925. The only mention of Rule 23 that the Chancery Court ever made in this case was contained in a *pro forma* statement supported by neither reasons nor evidence in the record. *See* Chancery Court's Order and Final Judgment, at 2 ("[I]t is hereby . . . determined that the plaintiffs in these Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class and that the maintenance of this action as a class action meets all the requirements of Rule 23(a) and (b)(3) of the Court of the Chancery"). While we need not decide the issue, we are doubtful that this *pro forma* recital satisfies *Prezant*.

give full faith and credit to such a judgment because it would violate due process of law. As the Epstein plaintiffs aptly put it, "*[o]bjectors are objectors, not class representatives.*" Reply Br. at 17-18. Binding absentees to any part of a class action judgment "is an act of judicial power," *Epstein I*, 50 F.3d at 667, and that power can only be exercised over absentees when their interests have, in fact, been adequately represented by parties lawfully authorized to represent them. *See, e.g., Richards v. Jefferson Cty., Ala.*, 116 S. Ct. 1761, 1766 (1996) ("[O]ne is not bound by a judgment *in personam* in a litigation in which he is not designated as a party . . . [except, in a class action, where he] has his interests adequately represented."). It would defy this fundamental principle of our jurisprudence to allow the due process right of absent class members to adequate representation to be litigated by random, volunteer objectors.[7]

Not surprisingly, Matsushita offers no persuasive authority in its attempt to argue against this basic principle. Some of the cases that it cites involve individual litigants, not class members. In *Durfee v. Duke*, 375 U.S. 106 (1963), for example — upon which Matsushita relies heavily — the Supreme Court held that an individual who has unsuccessfully challenged subject matter jurisdiction in an initial action can be precluded from raising the issue in a collateral attack on the judgment. *Durfee* was not a class action and says nothing about the rights of absent class members. Some of Matsushita's other cases pre-date *Philips*

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7. Absent class members are, of course, bound by a judgment on the merits of the class action issues, as for example, the fairness of the settlement.

Petroleum v. Shutts, 472 U.S. 797 (1985), the controlling Supreme Court precedent on the rights of absent class members. *See infra*, Section I.C. *See, e.g., Laskey v. International Union, United Auto., Aerospace & Agric. Implement Workers (UAW)*, 638 F.2d 954 (6th Cir. 1981). The only case Matsushita cites that offers any help on its proposition that volunteer objectors can litigate the due process rights of absent class members is *Grimes v. Vitalink Communications*, 17 F.3d 1553 (3d Cir. 1994). In *Grimes*, the Third Circuit held that objectors may litigate the due process rights of absent class members who have sufficient minimum contacts to support an exercise of personal jurisdiction over them by the forum. It reasons that, so long as an absentee has "minimum contacts" with the forum, he can be bound by the judgment without receiving *Shutts*' safeguards. *See Grimes*, 17 F.3d at 1558-59, 1560 & n.8. There is nothing in *Shutts*, however — or in any other case — to suggest that *Shutts* offers protection only to those absentees who are beyond the *in personam* reach of the forum. Because *Grimes* conflates the requirements of *in personam* jurisdiction with the due process safeguards that *Shutts* guarantees to absent class members, we respectfully decline to follow it.

Finally, Matsushita raises the alarmist cry that it will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation. *See* Appellees' Br. at 2. We of course reject this hyperbole. So does Delaware. In *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), the Delaware Supreme Court points out that prudent class action defendants can protect themselves from collateral attack. Although they cannot

foreclose a subsequent collateral action absolutely, they can minimize the risk by asking for a judicial finding, supported by reasons and evidence in the record, that the plaintiffs' "due process right to adequate representation has been satisfied." *Prezant*, 636 A.2d at 925-26. Such a finding will "help insure" that judgments will be subject to collateral attack only under extraordinary circumstances like those that exist in this case. *See id.* Thus, we disagree with Matsushita that finality of settlements will come to an end if volunteer objectors are not vested with the authority to bind absentees on the issue of the adequacy of class representation.

To repeat, "[o]bjectors are objectors, not class representatives." Reply Br. at 17-18 (emphasis removed). The individual objectors who voluntarily appeared at the fairness hearing were not authorized by the absentees to represent their interests, nor were they certified by the state to do so. Their appearance at the hearing did not bind anyone but themselves to an adjudication of adequacy of representation.

C

Finally, Matsushita argues that because of the procedures used in the Delaware Chancery Court, the Epstein plaintiffs cannot bring a collateral attack on adequacy of representation. This argument comes in two parts. First, Matsushita argues, the settlement hearing provided a "full and fair opportunity" for absentees to contest the adequacy of their representation. Appellees' Br. at 25. The absentees had a duty to intervene in that hearing if they wished to protect their rights, Matsushita claims, and having failed to

do so, they are estopped from bringing a collateral challenge. Second, and more broadly, Matsushita argues that the procedures Delaware had in place foreclose us from *ever* hearing a collateral challenge to adequacy of representation. Matsushita argues that we are limited to reviewing the sufficiency of the *procedures* that Delaware had in place to ensure adequate representation, rather than the adequacy of the representation itself. "[T]he Chancery Court's adherence to Rule 23 procedures satisfies the Due Process Clause as a matter of law," Matsushita continues, and an absent class member's claim on "the merits" of inadequate representation "is far outside the scope of the [collateral] review permitted by . . . the case law of this Court." Appellee's Br. at 30. We agree with the Epstein plaintiffs that both of these arguments are meritless.

1

Matsushita argues that class members who wish to contest adequacy of representation must intervene during the course of the class action proceedings and do battle with their own representatives in an adversarial contest over the way they are discharging their fiduciary duties. This argument ignores the clear teaching of *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1984), that a class member is not required to do anything during the course of a class-action proceeding. He is free to sit it out, assured that he will be bound by the result if, but only if, the proceeding comports with the special due process requirements designed to safeguard the interests of absent class members. As the Court put it in *Shutts*, "Unlike a defendant in a normal civil suit, an absent class-action plaintiff is not required to do anything.

He may sit back and allow the litigation to run its course, *content in knowing that there are safeguards provided for his protection.*" *Id.* at 810 (emphasis added). Those "safeguards", as enumerated in *Shutts*, are (1) "notice," (2) "an opportunity to be heard and participate in the litigation," (3) "an opportunity to remove himself from the class" by opting out, *and* (4) "adequate represent[ation]" "*at all times.*" Id. at 812 (emphasis added). Thus, *Shutts* admonishes absent class members that they will be bound by the merits of a judgment — including the fairness of a court-approved settlement — if it is a product of adequate representation and their other due process safeguards. But *Shutts* promises in return that they need not monitor this proceeding from afar: if the litigation culminating in the judgment violated their due process rights, then absent class members will not be bound by it.

Gonzales v. Cassidy, 474 F.2d 67 (5th Cir. 1973) — a precursor to *Shutts* — is square authority against Matsushita's intervene-or-be-estopped argument. In *Gonzales*, the Fifth Circuit rejected the very argument that Matsushita now urges upon us: "[The defendants] advance an estoppel-type argument to support the proposition that [the absent class member] cannot raise the inadequate representation issue [on collateral review]. Their position is that [the absent class member] is estopped to attack the judgment because he should have intervened." *Id.* at 76.

In rejecting this argument and holding that an absent class member may collaterally attack a judgment on the ground that he was not adequately represented, the Fifth Circuit reasoned that the question "whether counsel's

conduct of the entire suit was such that due process would not be violated by giving res judicata effect to the judgment in that suit," *id.* at 74, "*necessarily requires a hindsight approach.*" *Id.* at 73 n.11 (emphasis added). As the court went on to say, "The purpose of Rule 23 would be subverted by requiring a class member who learns of a pending suit involving a class of which he is a part to monitor that litigation to make certain that his interests are being protected . . . ." *Id.* at 76.[8]

A hypothetical based on the facts of our case serves to illustrate the common sense soundness of *Shutts* and *Gonzales* and the impracticality of Matsushita's argument that the Epstein plaintiffs are now estopped from challenging the adequacy of representation because they failed to intervene at the fairness hearing. Suppose a class member did appear as an objector at the hearing and challenged the fairness of the settlement on the ground that it had not taken into account the claim that a $21-million payment to Sheinberg was in reality a premium for his stock. *See infra*, Section II.B.2. Suppose further that the objector produced evidence in the form of deposition testimony and documents — perhaps discovered in a parallel federal class action — casting doubt on the real purpose of the $21-million payment. Suppose still further that Delaware counsel had never heard of the $21-million payment before the objector reported it at the fairness hearing.

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8. Delaware's class action provision is modeled after its federal counterpart. *Compare* Del. Chancery Court Rule 23 *with* Fed. R. Civ. Proc. 23. *See also Hoffman v. Cohen*, 538 A.2d 1096, 1098 (Del. 1988) ("[T]he construction of [the Federal Rules of Civil Procedure] by the federal judiciary is of great persuasive weight in the construction of the [Delaware Rules].") (citation omitted).

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The question is: how should class counsel have responded to this new evidence about the Sheinberg payment during the middle of the fairness hearing, given their fiduciary duty to look after the interests of all members of the class? The obvious answer would seem to be to ask the Vice Chancellor to continue the fairness hearing until they had a chance to learn more about the Sheinberg payment and consider its potential settlement value. After all, if there was evidence to prove that the $21-million payment was a premium to get Mr. Sheinberg to support the tender offer, it would take only a simple calculation to determine that other shareholders would be entitled to a substantial recovery. *See infra*, Section II.B.2.

Let us suppose, however, that for whatever reason — perhaps the irresistability of a quick fee on claims they could not litigate — counsel stuck to their guns and got the proposed settlement — 2¢ per share (less attorneys fees) — approved and cast into a judgment. Could the law possibly be that all the class members who failed to intervene at the fairness hearing are estopped from challenging the judgment collaterally on the ground that they were not provided adequate representation? Common sense as well and *Shutts* and *Gonzales* dictate that the answer must be that they are not.

This dilemma is the driving force behind *Gonzales*' reasoning. The impracticality of assessing the adequacy of ongoing representation "live-time" is the very reason that the Fifth Circuit in *Gonzales* insisted that the challenge must be conducted with a "hindsight" approach, as on collateral review. Matsushita attempts to turn this around and limit

Gonzales' scope to cases in which it was "impossible to raise" the constitutional claim in the original proceeding. See Appellees' Br. at 35-26 ("*Gonzales* also turns on the impossibility of participation in the original proceeding. . . . *Gonzales* thus stands for the limited proposition that [collateral attack is limited to] due process violations that could not have been presented in the rendering court prior to the entry of judgment.").

This is not what *Gonzales* held. On the contrary, it held that even claims that were not "impossible" to have been raised in the initial proceedings are entirely appropriate for collateral review:

> To answer the question whether the class representatives adequately represented the class so that the judgment in the class suit will bind the absent members of the class requires a two-pronged inquiry: (1) did the trial court in the first suit correctly determine, initially, that the representative would adequately represent the class? and (2) Does it appear, after the termination of the suit, that the class representative adequately protected the interest of the class?

Gonzales, 474 F.2d at 72.

To hold otherwise — with respect to either prong of the inquiry — would be to require absent class members to monitor the proceedings in order to secure their rights to adequate representation. Absent class members are not required to bear this burden. *See Shutts*, 472 U.S. at 810;

Gonzales, 474 F.2d at 76 ("The [adequate representation safeguard] would be subverted by requiring a class member . . . to monitor the litigation . . . ."). They may rest secure in the knowledge that they can attack the judgment in a subsequent action if their due process rights are in fact violated. "Due process of law would be violated for the judgment in a class action suit to be res judicata to the absent class members unless *the court applying res judicata* can conclude that the class was adequately represented in the first suit." *Gonzales*, 474 F.2d at 74 (citing *Hansbury v. Lee*, 311 U.S. 32 (1940)) (emphasis added).[9] Indeed, to permit such a due process challenge to be definitively resolved in the initial proceeding would effectively permit an initial court to pronounce the preclusive effect of its own judgment. *See Matsushita*, 116 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("A court conducting an action cannot predetermine the res judicata effect of the judgment; that effect can be tested only in a subsequent action.") (citing 7B *Charles A. Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure* § 1789, at 245 (2d ed. 1986)).

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9. Matsushita offers yet another argument in its attempt to foreclose us from making this assessment. It claims that, because we are a *federal* tribunal, § 1738 forecloses us from reviewing the adequacy of the representation afforded absent class members in a *state* proceeding, even though another state court would be able to hear the claim. The Supreme Court has rejected this argument. *See Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 482 (1982) ("A state may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state *and federal* courts are not required to accord full faith and credit to such a judgment.") (emphasis added) (footnote omitted).

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In adopting *Gonzales*' reasoning (and rejecting Matsushita's spin on it), we bring our circuit into line with settled law that forecloses Matsushita's intervene-or-be-estopped theory. As the Court stated in *Shutts*, "an absent class-action plaintiff is not required to do anything." *Shutts*, 472 U.S. at 810. Rather, it is the prerogative of absentees to remain just that: *absent* from a proceeding in which they are "parties" only virtually, through their class representatives. The "continuing solicitude for their rights" entitles absent class members to refrain from intervening, "content in knowing that there are safeguards provided for [their] protection." *Id.* at 810. By forcing an absent class member to monitor a proceeding and intervene to challenge the adequacy of representation that he is still in the process of receiving would defeat the purpose of having such safeguards. As Justice Ginsburg further made clear in her separate opinion in *Matsushita*: "[An absent class member] may avoid being bound *either* by appearing in the action before rendition of the judgment *or by attacking the judgment by subsequent proceedings*." *Matsushita*, 112 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) (first emphasis in original, second emphasis added) (quoting Restatement (Second) of Judgments § 41, Comment a, p. 394); *see also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4455, at 479 (1981) ("[Adequate representation] ordinarily is . . . determin[ed] in defining any class that is certified. *The question remains open to redetermination in a subsequent action*, however, since nonparties can be bound only if some party adequately represented their interests.") (emphasis added); *Gonzales*, 474 F.2d at 76 (absent class member has no duty to monitor class action proceeding); *cf. Martin v.*

Wilks, 490 U.S. 755, 762-65 (failure to intervene did not estop non-parties from suing parties to consent decree that adversely affected their interests).

2

Matsushita attempts to avoid *Shutts* by arguing that *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461 (1982) prevents absentees from ever collaterally challenging adequacy of representation when the forum state uses a procedure like Delaware Chancery Court Rule 23. This attempt gets Matsushita nowhere. We reiterate the fundamental principle that *Shutts* established: absent class members have a right to adequate representation "at all times," and they have no duty to intervene in the initial proceeding in order to protect that right. *Shutts*, 472 U.S. at 812. There is nothing in *Kremer* to the contrary.

In *Kremer*, the Court reaffirmed the bedrock principle that a judgment must satisfy the requirements of due process in order to receive full faith and credit. In the specific case before it, the Court held that a New York administrative proceeding was entitled to full faith and credit because the procedures it employed satisfied due process. Matsushita argues that *Kremer* likewise limits absent class members to a "procedures only" approach when they seek to challenge adequacy of representation. It points to passages in *Kremer* that ask whether the New York administrative proceeding provided the "minimum procedural requirements" of due process. *Kremer*, 461 U.S. at 481. It then argues that the mere existence of Rule 23 satisfies the "minimum procedural requirements" for protecting adequacy of representation.

That being so, Matsushita concludes, *Kremer* never permits a collateral challenge that alleges that absent class members *in fact* received inadequate representation.

We categorically reject this simplistic application of *Kremer* to the class action context. The Court fashioned *Kremer*'s "procedures only" approach to apply to collateral challenges of judgments in traditional litigation, where individual parties are bound by virtue of their *presence* before the court. *Kremer* was not a class action and did not address the special due process problems of binding persons not parties to the action. *Shutts*, in contrast, which was a class action, held that absentees have a right to adequate representation "at all times," 472 U.S. at 812, and that they need not intervene to enforce that right. No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause. The Court recognized this salutary principle in *Hansbury v. Lee*, 311 U.S. 32 (1940), and it has never retreated from it. *See id.* at 41-42 ("members of a class not present as parties to the litigation may be bound by the judgment where they are *in fact* adequately represented") (emphasis added).

Nonetheless, Matsushita argues, the absent class members in this case received notice, an opportunity to be heard (at the objection hearing), and the right to opt out of both the class action proceeding and the proposed settlement. Surely, Matsushita complains, these protections fully satisfied the "minimum procedural requirements" of *Kremer*, and due process does not require anything more.

The Supreme Court, however, could not have been more clear in requiring more. Indeed, if settled law defeats

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Matsushita's contention that absent class members have a duty to intervene or be estopped from challenging the adequacy of their representation, then this contention faces a veritable fortress of authority. In *Shutts*, the Court echoed the language of *Kremer* when it laid out the "minimum procedural due process protection" due to absent class members, including "adequate represent[ation]" "at all times." *Shutts*, 472 U.S. at 811-12. In addition to *Shutts*, the case law is consistent that adequate representation *in fact* is required to bind absent plaintiffs. *See Richards v. Jefferson Cty.*, 116 S. Ct. 1761, 1766 (1996); *Matsushita*, 116 S. Ct. at 885 (Ginsburg, J., concurring in part and dissenting in part); *Hansbury*, 311 U.S. at 41-43; *Crawford v. Honig*, 37 F.3d 485, 487 (9th Cir. 1994); *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 390 (9th Cir. 1992); *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1278 (9th Cir. 1992); *In re Real Estate Title and Settlement Services Antitrust Litig.*, 869 F.2d 760, 769 (3d. Cir. 1989); *see also* Restatement (Second) of Judgments §§ 41 & 42 (1982); 18 Charles A. Wright, Arthur R. Miller, and Edward H. Cooper, Federal Practice and Procedure § 4455, at 477 (1981) ("Adequate representation [in fact] is required to support preclusion by judgment in a class action.").

None of the cases cited by Matsushita offer support for its position that absent class members who receive notice and a chance to opt out of a settlement are foreclosed from challenging adequacy of representation. Matsushita places particular reliance upon two Ninth Circuit cases — *Torrisi v. Tucson Electric Power Co.*, 8 F.3d 1370 (9th Cir. 1993), and *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173 (9th Cir. 1977). Neither of these cases speak to the rights of *absent*

class members, however; they involve challenges by persons who represented themselves before the court in class action proceedings.

Torrisi involved a direct appeal of a settlement judgment by class members who chose to participate in the trial court proceedings as objectors to the settlement, rather than resting on their *Shutts* right to be represented as absentees. *See Torrisi*, 8 F.3d at 1370, 1375 n.2 (9th Cir. 1993) (noting that litigants filed objections, opposed settlement, and "participated in the settlement hearing and argued against approval of the settlement"). Thus, *Torrisi* stands for the unremarkable proposition that class members who choose to protect their interests by intervening in the trial court proceedings — instead of relying on the representation of class counsel — are bound to the resulting judgment and may not get a second bite at the apple by attacking it collaterally. *See also Matsushita*, 116 S. Ct. at 888 (Ginsburg, J., concurring in part and dissenting in part) ("[T]he represented person may avoid being bound *either* by appearing in the action before rendition of judgment *or* by attacking the judgment by subsequent proceedings.").

Torrisi does not discuss or even allude to the rights of absent class members. Indeed, *Torrisi* does not even cite *Shutts*, the leading authority on the due process rights of absent class members. Faced with the task of explaining this omission, Matsushita attempts to distinguish *Shutts* from *Torrisi* on the ground that *Shutts* did not involve a settlement, but rather an adjudication of a class action. Matsushita fails to cite a single case in support of its argument that *Shutts*' requirement of adequate representation "at all times," *Shutts*,

472 U.S. at 812, may be diluted in class settlement proceedings. Nothing in *Shutts* suggests a "sub-class" of settlement class actions in which class members are only entitled to lesser due process protections, and we see no principled basis for so limiting *Shutts*. Quite to the contrary, Matsushita's argument regarding settlement class actions was rejected by the Supreme Court in *Amchem Products v. Windsor*, 117 S. Ct. 2231 (1997).

In *Amchem*, the Court reviewed a settlement class action certified by the Third Circuit in asbestos litigation. In the course of its analysis, the Court held that the safeguards designed for the protection of absent class members — including adequate representation — "demand undiluted, even heightened, attention in the settlement context." *Id.* at 2248. As the Court explained, such heightened attention is necessary because a court that certifies a class for the purpose of settling claims rather than litigating them will "lack the opportunity, present when a case is litigated, to adjust the class, informed by the proceedings as they unfold." *Id.* at 2248. Moreover, to collapse absentees' right of adequate representation into their right to review and opt out of the settlement would be to "substitute for Rule 23's certification criteria a standard never adopted — that if a settlement is "fair," then certification is proper." *Id.* at 2249. "Federal courts . . . lack authority" to make such a substitution. *Id.* *See also Prezant*, 656 A.2d at 924 (rejecting proposition that notice and opt out rights, without adequate representation, satisfy due process for settlement class actions). Matsushita's attempt to read into *Torrisi* a reduced standard of protection for absentees in settlement class actions is foreclosed by *Amchem*.

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Matsushita also cites *Holiday Magic* for the proposition that notice and opt out rights may substitute for the right of absent class members to adequate representation in a settlement class action. *Holiday Magic*, however, is inapposite for the same reason as *Torrisi*: it did not involve absent class members. As did *Torrisi*, *Holiday Magic* involved an appeal of a class settlement judgment by class members who appeared in the trial proceedings — in this case, as parties to the original action. *See Holiday Magic*, 550 F.2d at 1175 ("Appellants . . . filed as cross-plaintiffs [below]."). In *Holiday Magic*, our court addressed and rejected the *merits* of the appellants' claim that they had been inadequately represented. *See id.* at 1176-79. It then added — in dictum, and over the objection of then-Judge Anthony Kennedy — that it did not think that individuals who had an opportunity to opt out of the settlement after receiving notice of its terms should be allowed to "play the role of spoilers for a class of more then 31,000 people" by challenging the validity of the entire settlement on grounds of inadequate representation. *Id.* at 1177; *see also Holiday Magic*, 550 F.2d at 1179-80 (Kennedy, J., concurring) (agreeing that representation was in fact adequate but rejecting suggestion of majority that opt-out rights can substitute for adequate representation). To the extent that the panel was concerned by the prospect that an uncertified class member could forcibly bind the entire class to the result of his own claim of inadequate representation, we agree, and have held that individual objectors may not bind anyone but themselves on that issue. *See supra*, Section I.B.2.[10]

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10. In any event, *Holiday Magic* was superseded by *Shutts*, which is now the controlling authority on the rights of absent class (Cont'd)

All the other cases that Matsushita cites in support of its position suffer from similar problems. Many involve *individual* litigation and do not speak at all to the rights of absent class members. *See, e.g., Kremer*, 456 U.S. at 461; *Durfee v. Duke*, 375 U.S. 106 (1963); *Osborn v. Ashland Cty. Bd. of Alcohol, Drug Addiction & Mental Health Svcs.*, 979 F.2d 1131 (6th Cir. 1993). Some are like *Torrisi* — class actions in which the collateral attack was launched by class members who appeared and represented themselves in the initial action. *See, e.g., Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991); *Sandler Assoc. v. BellSouth Corp.*, 818 F. Supp. 695 (D. Del. 1993), *aff'd*, 26 F.3d 123 (3d Cir. 1994). And some are like *Holiday Magic* — they pre-date *Shutts*, the controlling authority on the due process rights of absent class members. *See, e.g., Laskey v. UAW*, 638 F.2d 954 (6th Cir. 1981). None speaks authoritatively to the rights of absent class members who claim inadequate representation by their class fiduciaries.

In sum, neither caselaw nor common sense supports Matsushita's position that the mere existence of procedures like Rule 23 can foreclose an absentee from receiving his day in court on the issue of adequacy of representation. Rather, the established practice of our circuit is exemplified

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(Cont'd)
members. To the extent that *Holiday Magic* is inconsistent with *Shutts*, we must, of course, follow the latter. *See Catli v. Catli*, 999 F.2d 1405, 1408 n.5 (9th Cir. 1993) ("Although we must ordinarily adhere to Ninth Circuit precedent, we may reexamine that precedent without the convening of an en banc panel where our precedent has been nullified by a subsequent Supreme Court decision.") (citation omitted).

by *Brown v. Ticor Title*. In that case, we entertained the merits of a collateral challenge by absent class members to adequacy of representation, stating unequivocally that "if the plaintiff was not adequately represented in the prior action or there was a denial of due process, then the prior decision has no preclusive effect." *Brown v. Ticor Title Ins. Co.* at 390 (citing *Hansbury v. Lee*, 311 U.S. 32 (1940)). Matsushita simply cannot overcome the settled law that absent class members need not do anything during the course of the proceeding, "content in knowing that there are safeguards provided for [their] protection," including the requirement that they be "adequately represented" "at all times." *Shutts*, 472 U.S. at 811-12.

II

We now turn to the merits of the adequacy of representation issue. Following the model provided by *Gonzales*, we conduct a "two-pronged inquiry," *Gonzales*, 474 F.2d at 72.[11] First, we determine whether there was a disabling conflict of interest between Delaware counsel and the MCA shareholders who tendered their shares. Second, we review the actual conduct of Delaware counsel in

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11. In *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir. 1992), our Circuit adopted *Gonzales*' model for conducting an analysis of adequacy of representation (although distinguishing *Gonzales*' result), with one additional requirement. We held that, on collateral attack, "a party must show . . . that the opposing party was on notice of facts making [the alleged inadequacy of the representation] apparent." *Id.* at 390-91. In this case, that requirement is easily met, as Matsushita was on notice of all the information in the record on which we base our analysis.

discharging their fiduciary duty to protect the interests of those shareholders. *See id.* at 72-77.

A

The essence of the Epstein plaintiffs' position on the claimed conflict of interest is that the Delaware settlement was the product of a one-sided bargaining process because their representatives went to the table with no credible bargaining power. Not surprisingly, Matsushita makes no serious attempt to challenge this position, relying almost exclusively on their arguments as to why we cannot reach the merits. *See* Appellees' Br. at 41-44. It is axiomatic that a plaintiff's power to negotiate a reasonable settlement derives from the threat of going to trial with a credible chance of winning. As the Supreme Court has said, permitting class-action settlements in which class counsel are disabled from litigating the case renders:

> both class counsel and court . . . disarmed. Class counsel confined to settlement negotiations could not use the threat of litigation to press for a better offer, see Coffee, Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L.Rev. 1343, 1379-1380 (1995), and the court would have to face a bargain proffered for its approval without the benefit of adversarial investigation, see, *e.g.*, *Kamilewicz v. Bank of Boston Corp.*, 100 F.3d 1348, 1352 (C.A.7 1996) (Easterbrook, J., dissenting from denial of rehearing en banc) (parties "may even put one over on the court, in a staged performance"), cert. denied, 520 U.S. __, 117 S.Ct. [sic] 1569, 137 L.Ed.2d 714 (1997).

Amchem, 117 S. Ct. at 2248-49 (1997) (per Ginsburg, J.); *see also Kamilewicz*, 100 F.3d at 1352 (Easterbrook, J., joined by Posner, C.J., and Manion, Rovner, and Diane P. Wood, JJ., dissenting from denial of rehearing en banc) ("The lawyers support the settlement to get fees; the defendants support it to evade liability; the court can't vindicate the class's rights because the friendly presentation means that it lacks essential information.")."

The Delaware class plaintiffs and their counsel could not carry out a threat to litigate the federal claims in this case, and Matsushita knew it.

The inability of the class representatives to exercise any leverage on behalf of the Epstein plaintiffs was the result of three basic facts. First, they could not litigate the federal claims because Congress has said that Exchange Act claims may not be litigated in state courts. Thus, the claims that Matsushita violated SEC Rule 14d-10 by paying premiums to Messrs. Wasserman and Sheinberg were not and could not have been pleaded in the Delaware action. Moreover, there was no discovery on those claims; indeed, the Delaware plaintiffs probably were *unable* to conduct any discovery on the federal claims because the facts relevant to those claims had no apparent relevance to the subject matter of the state law claim that the MCA directors had breached their fiduciary duties in failing to maximize shareholder value upon a change of corporate control. *See Epstein I*, 50 F.3d at 659; Del. Chancery Court Rule 26(b)(1). Finally, Matsushita would have had reason to discount the value of any settlement made with the state plaintiffs against the risk that a state court judgment releasing Exchange Act claims would not survive

a collateral attack on the ground that the Delaware courts had no jurisdiction to release exclusively federal claims especially in light of the absence of any overlapping issues of fact between the state and federal claims. *See Epstein I*, 50 F.3d at 662-65.[12] Matsushita must have recognized that it would subject itself to a substantial risk by settling the federal claims in state court rather than federal court, and would have had to discount its bottom line in the state settlement negotiations accordingly. The denouement was predictable: Matsushita used its infinitely superior bargaining power vis-a-vis the state class representatives to settle the Exchange Act claims at a rock bottom price.[13]

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12. We note that this additional factor, though instructive in giving a full picture of the relative bargaining strength of the parties in this case, is not necessary to our holding that Delaware counsel's representation of the Epstein plaintiffs was inadequate.

13. Indeed, it would not be an exaggeration to say that the Delaware plaintiffs were kept in state court entirely at the sufferance of Matsushita. As we discuss below, the Delaware Vice Chancellor, in rejecting the first settlement, determined that the state law claims were "extremely weak" and had "little or no value" because no such state cause of action existed. *See In re MCA Shareholders Litigation*, 598 A.2d 687, 694 (Del. Ch. 1991); *infra*, Section II.B.2. Matsushita could have, but did not move the Chancery Court to dismiss the state action. Rather, it chose to use it as a vehicle for seeking an inexpensive release of the federal claims. *See also* 18 *Charles A. Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure* § 4470, at 526 (Supp. 1997) ("In approving the settlement, the Delaware Vice Chancellor observed that the defendants seemed more bent on escaping potential liability under federal law than on avoiding state-law claims that the Vice Chancellor had earlier characterized as extremely weak.").

Second, the class representatives not only lacked the bargaining power that comes with a credible threat of going to trial and winning, they also lacked the ability to make a credible threat that they could put Matsushita at risk by going to trial on the state claims and proving facts material to the federal claims that would be binding upon Matsushita through issue preclusion. Because the state and federal claims shared no common issues of material fact, a judgment on the state claims could not be used as an "offensive" estoppel in future litigation of the federal claims. *See Epstein I*, 50 F.3d at 665-55. While the Delaware class representatives lacked the muscle to put Matsushita at risk on the federal claims, the existence of their state class action, however worthless standing alone, served to provide Matsushita with an opportunity to try to get rid of the federal claims at a bargain basement price. If the parties could get court approval of a settlement that released the federal claims, Matsushita would have at least a fair shot of using the judgment to block the federal action with a full faith and credit argument. That is, of course, exactly what Matsushita did as soon as the judgment became final. We had the Epstein plaintiffs' appeal of the district court's summary judgment under submission when Matsushita notified us of the Delaware settlement judgment and argued that we should give it preclusive effect.

Third, Matsushita had a further bargaining advantage, quite apart from its knowledge that the Delaware plaintiffs could not put it at risk on the federal claims. Matsushita also knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims. Class counsel could not benefit from the federal claims by going to trial

for the obvious reason that the federal claims could not be litigated in state court. Moreover, the pendency of a parallel action in federal court — the *Epstein* case — meant that Delaware class counsel were at risk of being "beaten to the punch" and getting no return on the federal claims at all. Matsushita knew that it was negotiating a release of the federal claims with class counsel who could not litigate those claims and whose self-interest gave them an incentive to settle and settle fast.

What all this demonstrates is that there was a jarring misalignment of interests between class counsel and members of the federal class. It was plainly in the best interest of counsel to settle the federal claims at any price. For them, any settlement was better than no settlement because settlement was the only way they could make any money on the federal claims — indeed, given that the state claims were essentially worthless, it was the only way that Delaware counsel could get any compensation at all. Delaware counsel were not, after all, serving as *pro bono* counsel to the MCA shareholders who tendered their shares.

It was not, in contrast, in the best interest of the clients — the MCA shareholders — to settle their Exchange Act claims at any price. Their interest lay in settling those claims for a sufficient amount to make it imprudent to take the risk of litigation. That risk, of course, would have to be realistically assessed in terms of the chances of prevailing on either or both of their claims that Matsushita had violated SEC Rules 10b-13 and 14d-10 in paying premiums to Messrs. Wasserman and Sheinberg. Indeed, the misalignment of interests and incentives between class counsel and their

clients in these extraordinary circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

This was not the adequate representation of absent class members that due process requires "at all times." *Shutts*, 472 U.S. at 812. As we have said, "An adequate representative must . . . be free from economic interests that are antagonistic to the interests of the class." *Larson v. Dumke*, 900 F.2d 1363, 1367 (9th Cir. 1990). The interests of Delaware counsel in this case were nothing but antagonistic to the interests of the MCA shareholders who tendered their shares. As a result of the three factors described above, which make this case extraordinary on its facts, Delaware counsel's overriding economic interest lay in settling the federal claims at any price and winning the race to judgment. The interests of the MCA shareholders who tendered their shares, in contrast, lay in pursuing those claims vigorously and either obtaining a reasonable settlement or litigating the claims in federal court. Their interests certainly did not lie in agreeing to a settlement that gave the attorneys a $1,000,000 fee but nothing for themselves — the settlement originally proposed by Delaware counsel — nor in agreeing to a settlement of 2¢ per share, inclusive of attorneys' fees — the settlement Delaware counsel ultimately persuaded the Vice Chancellor to approve. The inability of Delaware counsel to litigate the federal claims, their further inability even to obtain a judgment on the state law claims that could have had issue preclusive effect on the federal claims, and the pendency of a competing parallel class action in federal court caused the economic interests of Delaware counsel to be fundamentally "antagonistic to the interests" of the Epstein plaintiffs. *Id.*

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As we have previously said — and as pure common sense dictates — "Adequate representation . . . depends on . . . an absence of antagonism." *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 390 (9th Cir. 1992). Here, there is no question that there was antagonism between the interests of the lawyers and the interests of their clients. That antagonism made their representation of the MCA shareholders who tendered their shares inadequate as a matter of law.

B

In addition to the argument that Delaware counsel had a disabling conflict of interest, the Epstein plaintiffs contend that the actual conduct of Delaware counsel in settling the federal claims fell far short of the representation that due process requires. Rather, they claim, Delaware counsel completely failed to investigate or develop their federal claims and basically "rolled over" during settlement negotiations, ultimately entering into a settlement that was essentially worthless except for their own fees. This course of conduct, they conclude, falls well below the level of representation that is required to bind absentees. We agree.

Adequate representation requires that counsel "vigorously and tenaciously protect[ ] the interests of the class." *Gonzales*, 474 F.2d at 75. "Vigorous" and "tenacious" protection requires, at a minimum, that counsel pursue their clients' claims, make a reasonable effort to assess the fair settlement value of those claims, and pursue a settlement that approximates that value, always taking into account the ever-present risks of litigation. The inadequacy of Delaware counsel's representation is brought into sharp focus by their

vigorous *disparagement* of the federal claims throughout the course of the settlement proceedings. Indeed, Delaware counsel's representation of those claims surpassed inadequacy and sank to the level of subversion. Counsel consistently sought to convince, not only their clients, but their adversaries and the Chancery Court itself that the federal claims had no merit. They repeatedly and summarily dismissed those claims as "frivolous" without ever conducting any discovery or any meaningful analysis of the legal issues, much less presenting the claims in a favorable light. *See* SR 171-72. In sharp contrast, the Epstein counsel earnestly pursued those same claims in federal court, recognizing their merit and successfully demonstrating that merit in persuading this court to reverse an adverse summary judgment ruling below. This contrast makes it all the more clear that Delaware counsel's representation of the MCA shareholders who tendered their shares fails even the most minimal standards of adequacy.

1

Barely fifteen days after the Epstein counsel filed a class action in federal court on the exclusively federal claims, Delaware counsel negotiated the release of those claims. This first Delaware settlement proposed to release all claims, state and federal, arising out of the Matsushita-MCA merger, in exchange for $1 million *in attorney fees*, *no* monetary compensation for shareholders, and an amended poison pill provision of dubious value. *See Epstein I*, 50 F.3d at 660; SR 75-76. In its notice to the class members regarding this settlement, Delaware counsel explained that the plaintiffs in the federal action alleged that Matsushita had violated SEC

Rule 14d-10 by offering Wasserman different and more valuable consideration for his shares than it offered to other tendering shareholders.[14] In recommending the settlement of those claims, counsel told their clients that "the substantial benefits the plaintiffs and the other members of the Class can expect to receive by virtue of the Settlement" outweighed "the risks, burdens and costs of continued litigation . . . [and the] uncertainties relating to proof of the allegations contained in the various actions." SR 76. Counsel put no flesh on this bare-bones analysis. In particular, they never explained why litigation of the state law claims would put the federal claims at "risk." Moreover, the notice for the settlement hearing offered no defense of the proposition that the benefits of the settlement were "substantial" in relation to the value of the federal claims it released. Rather, the notice merely assured class members that counsel had conducted "extensive investigation of the facts and examination of the law involved," SR 76, and had concluded that the settlement was fair. It is hard to imagine what Delaware counsel meant by an "extensive investigation," since the record shows no discovery at all on the facts underlying the federal claims. Indeed, this lack of discovery is hardly surprising. As discussed above, Delaware counsel were probably disabled from developing the federal claims through traditional discovery, since discovery in state court was limited to matters relevant to the subject matter of the state claims — that the MCA directors had violated their fiduciary duty to attempt to secure a better deal than the one

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14. At the time of the hearing on the first settlement proposal, the Epstein plaintiffs had not yet pled the Sheinberg claim. They did so some time after the Vice Chancellor rejected the first proposed settlement.

Matsushita offered the shareholders. *See* Del. Chancery Court Rule 26(b)(1); *supra*, Section II.A.

Indeed, the record is clear that Delaware counsel had not conducted an extensive investigation into the merits of the federal claims in order to determine their fair settlement value. Delaware counsel admitted to the Chancery Court that they had reviewed the Wasserman claim "relatively quickly" before concluding that the claim was "frivolous" and would be "a waste of our time." SR 171-72. In fact, in their cursory review, Delaware counsel simply adopted two of the defenses raised by *Matsushita* in federal court. First, Delaware counsel took Matsushita's position that claims under Rule 14d-10 should be limited to actions taken within a rigidly defined "tender offer period." SR 123-28; *see also Epstein I*, 50 F.3d at 653-54. Matsushita had claimed that this "pure timing" rule allowed it to give additional consideration to Wasserman by timing the exchange of his stock to occur immediately after Matsushita's acceptance for payment of all other shares tendered. *See Epstein I*, 50 F.3d at 653. Delaware counsel accepted Matsushita's "pure timing" rule uncritically and used it to disparage the Wasserman claim. SR 123-28.

Second, Delaware counsel agreed with Matsushita's position that the Wasserman agreement did not violate Rule 14d-10 because Wasserman actually received "substantially less than the cash consideration received by MCA's other stockholders." SR 129. Once again, the record shows no discovery activity at all. Instead, Delaware counsel simply accepted at face value Matsushita's position that "the Wasserman deal was less valuable than that provided to the other shareholders in the form of cash." SR 185. Epstein

counsel, in contrast, produced evidence and expert testimony in arguing that Wasserman's deal was structured in order to confer upon him considerable tax benefits, and that the after-tax value that Wasserman would receive was actually much greater than the value of the tender offer to the average shareholder. *See Epstein I* Appellants' Br. at 15-16, 55.

Despite the best efforts of Delaware counsel to disparage the Exchange Act claims of the absentees they were "representing," the Chancery Court rejected the first settlement because the Wasserman claim had "significant value" while the state law claims had "little or no merit." *In re MCA Shareholders Litig.*, 598 A.2d at 690. On the merits of the federal claim, the Chancery Court was far from convinced that Delaware counsel's pure timing rule controlled: "This issue has not yet been definitively addressed by the courts and therefore this [Rule 10b-13] claim . . . clearly has arguable merit." *Id.* at 695.[15] In addition, the Chancery Court refused to accept Delaware counsel's uncritical account of the value of Wasserman's deal: "Although it is claimed that the value of the consideration given to Wasserman had less value than the cash offered to the other stockholders, the true economic value of the Wasserman consideration is uncertain." *Id.* at 695.[16] In light

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15. Matsushita offered no authority and not much reasoning in support of this hypertechnical rule, while we offered reasons and contrary authority for rejecting it in a five page analysis. *See Epstein I*, 50 F.3d at 653-57.

16. In the summary judgment proceedings in federal district court, Matsushita did not controvert the allegation in the Epstein

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of the "substantial merit" of the Wasserman claim, the court held that it would be unfair to release all federal claims in a settlement that offers "no real monetary benefit to the Class" but awards the attorneys $1 million in fees. *Id.* at 695-96. The court dismissed the value of the revised poison pill provision as "illusionary [sic]." *Id.* at 696.

2

The record of the Delaware action shows no activity for the ten months following April 25, 1991. The case lay dormant until the district court in Los Angeles entered summary judgment on February 10, 1992.[17] *See* SR 625. During the same interval, Epstein counsel were vigorously pursuing the federal claims, as demonstrated by over ten pages of docket entries in district court. *See* SR 803-13. Eight months later, Delaware counsel agreed to settle the

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plaintiffs' complaint that Wasserman's consideration had a greater per share value than that received by other shareholders. The Epstein plaintiffs produced evidence on this issue, *see Epstein I*, 50 F.3d at 657 n.9, and we left the issue open for redetermination on remand, *see id.* at 657.

17. Matsushita also exhibited a curious degree of inaction during this period. Specifically, following the Chancery Court's determination that the state claims had "little or no merit," *In re MCA*, 598 A.2d at 690, Matsushita did not take the action that would seem to have been most advisable and move the Chancery Court to dismiss the claim. While we do not rest our holding in this case on any finding that there was collusion between Matsushita and Delaware counsel, we note the Chancery Court's comment that "suspicions abound." *In re MCA Shareholders Litigation*, 1993 WL 43024 (Del. Ch.) (Feb. 16, 1993), at *5.

exclusively federal claims for the sum of $2 million — a bare 2¢ a share, *inclusive* of attorney fees. *See* SR 352, 356. In advocating the second settlement to the class and the Vice Chancellor, Delaware counsel continued to disparage the federal claims. They rested their disparagement primarily on the position that the district court's entry of summary judgment was "dispositive as to [the federal claims'] lack of substantial merit." SR 460. They failed to point out, however, that the Ninth Circuit affords no deference to a district court's decision on summary judgment, but reviews such determinations *de novo*. *See, e.g.*, *Bagdadi v. Nazar*, 84 F.3d 1194, 1197 (9th Cir. 1996). Nor did Delaware counsel make any effort to assess the likelihood of reversal by the Ninth Circuit. They merely reiterated *Matsushita*'s arguments in an effort to convince the Chancery Court once again that the federal claims were worthless. In fact, *Delaware counsel specifically urged the Chancery Court "not [to] delve into the ultimate merits of [the federal] claims upon appeal as if it were reviewing de novo the dismissal*," but instead that it treat the district court's decision as "dispositive." SR 460.

Delaware counsel argued without explanation that it was "doubtful" that the Ninth Circuit would reverse the district court to hold either that there is a private right of action under Rules 10b-13 and Rule 14d-10, or to reject Matsushita's strict timing rule. SR 461-64. They urged the Chancery Court to give the dismissal of the federal claims "presumptive effect." SR 553. Counsel claimed to have "reviewed the law and . . . reviewed the briefs and . . . looked at the findings of fact"[18]

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18. A district court does not, of course, make "findings of fact" in ruling on a summary judgment motion. Findings of fact are made

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in the federal action before determining that the federal claims were "so fraught with uncertainty, that those claims are so weak, that the record in that proceedings . . . is so horrendous, that the prospect of anything emerging from that case is so remote, that $2 million more than adequately compensates — much more than adequately compensates for the release of all the federal and state claims." SR 555-56.[19] Without citing any caselaw regarding private rights of action under Rule 10b-13 or Rule 14d-10, Delaware counsel reasoned that, as a general matter, the Supreme Court and the Ninth Circuit had drastically narrowed the bases upon which private rights will be implied under any statute. *See* SR 461. Based on these generalizations and their reading of Rule 10b-13 and the implementing statute of Rule 14d-10,

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on the basis of evidentiary hearings and usually involve credibility determinations, which explains why they are reviewed deferentially under the clearly erroneous standard. *See* Fed. R. Civ. Proc. 52(a). As we have said, summary judgments are reviewed *de novo* by the Ninth Circuit.

19. Similarly, in their notice to the class members, Delaware counsel used the same boilerplate language found in the first notice of settlement, claiming that they had conducted "extensive investigation of the facts and examination of applicable law," and that they recommended settlement "after considering (i) the substantial monetary benefits that [class members] will receive pursuant to the Settlement; . . . [and] (iii) the attendant risks and delays of continued litigation." SR 353. Once again, counsel did not identify the "risks" involved in litigating the state law claims, nor did they explain why the benefits of settlement were "substantial," especially in relation to the value of the federal claims. *See supra*, Section II.B.1.

counsel concluded that the "weight of authority" suggested that neither Rule 10b-13 nor Rule 14d-10 authorizes a private right, SR 461-62, and characterized the federal claims as "lacking in substantial merit." SR 546.

Counsel's "analysis," however, disregarded two cases, from the Second and Third Circuits, that are square holdings that there is a private right of action under Rule 14d-10. *See Polaroid Corp. v. Disney*, 862 F.2d 987, 991, 997 (3d Cir. 1988); *Field v. Trump*, 850 F.2d 938, 946 (2d Cir. 1988). Counsel's failure to report these cases to class members and to the Vice Chancellor is even more astonishing given that they actually cited *Field* on the issue of the timing of the Wasserman transaction. For counsel not to cite *Field* on the private right of action issue, or to cite *Polaroid* at all, is inexcusable. Needless to say, Epstein counsel cited these cases to us on appeal, *see Epstein I* Appellants' Br. at 52-55, and we followed them and brought the Ninth Circuit into line with the Second and Third Circuits, finding that a private right of action does exist under Rule 14d-10. *See Epstein I*, 50 F.3d at 652.

Delaware counsel also stated without explanation that the Ninth Circuit was "unlikely" to overturn the district court's holding that the Wasserman transaction took place after the expiration of the tender offer period, or that Wasserman did not receive greater consideration for his shares than the other MCA shareholders received. *See* SR 464-67. Once again, counsel declined to mention that we would review the district court's summary judgment rulings *de novo*. As it did in the first settlement proceedings, counsel accepted without question Matsushita's self-serving valuation of the Wasserman deal, stating in a conclusory

fashion that the "lack of negotiability and relative risk" of Wasserman's preferred stock "more than sufficiently outweigh whatever tax benefits Wasserman may have derived." SR 467. Without discussing whether the value of the Wasserman consideration might present a genuine issue of fact, counsel simply stated that the district court's decision regarding the timing and value of the Wasserman transaction "would seem most unlikely to be overturned on appeal." SR 465.

Finally, to cap off their disparagement of their clients' Exchange Act claims, Delaware counsel asserted generally that the federal claims should not stand in the way of settlement because "damages on the federal claims are highly uncertain." SR 468. Counsel simply ignored the obvious: that damages on the Sheinberg claim, at least, were both easily calculable and uncontested. Matsushita paid Sheinberg $21 million in addition to the $66 in cash per share of MCA stock that it paid other shareholders. When divided by the number of shares that Sheinberg tendered, this $21-million payment would equal a premium of $17.80 per share. *See Epstein I*, 50 F.3d at 657. Thus, a simple calculation of $17.80 multiplied by the total number of shares outstanding — approximated as 78,000,000, *see* SR 556, 568-69 — would yield damages of about $1.4 billion on a successful Sheinberg claim. Even so, counsel stuck to its strategy of disparaging the federal claims in their effort to get the Vice Chancellor to approve the settlement that would produce them a fee.

In fact, there is not a single mention of the $21 million-payment to Sheinberg in Delaware counsel's memoranda or arguments to the Chancery Court. *See* SR 458-70; SR 538-63; 591-99. In their representations to the court concerning

the pending federal action, Delaware counsel stated only that the federal complaint "alleg[ed] that the arrangement whereby defendant Wasserman exchanged his MCA stock for preferred stock in the merged entity (1) violated SEC Rule 10b-13 . . . and (2) violated SEC Rule 14d-10." SR 439-40. They did not even mention the claim on the $21 million payment that had been pleaded in the Epstein plaintiffs' amended complaint.

It is clear, however, that Delaware counsel was aware of the Sheinberg claim. Counsel described that claim, if only briefly, in their notice to the class members as "a payment to defendant Sheinberg, which defendants asserted was . . . incentive compensation," SR 346, but which plaintiffs alleged was a "covert premium . . . designed to induce Sheinberg to tender his shares." *Epstein I*, 50 F.3d at 657. In contrast, Epstein counsel learned about the $21 million payment and investigated it, questioning both Wasserman and Sheinberg about it at their depositions. *See Epstein I* ER 357, Ex. V:51-53 (deposition of Wasserman), Ex. W:193-95 (deposition of Sheinberg). Their answers revealed that no MCA board documents prior to the date of the tender offer referred to any such payment to Sheinberg. *See id.*[20]

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20. Matsushita and MCA have contended that Sheinberg was entitled to incentive compensation for past services in the form of stock options, but the Epstein plaintiffs discovered that the minutes of MCA's board meetings contained no reference to any such stock options to Sheinberg prior to the time Matsushita made its tender offer. The evidence that does exist shows the payment to Sheinberg was to be made two days after Matsushita accepted the MCA shares for payment and that Matsushita approved the agreement to make the payment. *See Epstein I*, 50 F.3d at 657-59.

Epstein counsel relied in part on this evidence to argue the existence of a genuine issue of material fact and convince this court to reverse the summary judgment on this claim. *See Epstein I*, 950 F.3d at 658; *Epstein I* Appellants Br. at 32 (citing Wasserman and Sheinberg depositions conducted by Delaware counsel). Yet, despite the $17.80 per share value of the Sheinberg claim if a trier of fact were to find that the $21 million was a premium paid to induce Sheinberg to support the tender offer and not incentive compensation for past services, Delaware counsel stood mute on the claim while urging the Vice Chancellor to approve the settlement of $2 million, or 2¢ per share, inclusive of attorneys fees. Once again, the conduct of Delaware counsel in the performance of their fiduciary duties was inexcusable.

In sum, the only "vigorous" and "tenacious" work, *Gonzales*, 474 F.2d at 75, that Delaware counsel performed on behalf of the Epstein plaintiffs was to convince the Chancery Court to adopt their adversary's position and view the federal claims as essentially worthless. This was not merely "inadequate" representation, it was hostile representation that served the interests of counsel in getting a fee, but did not serve the interests of the MCA shareholders in getting a settlement based upon a thorough and fair assessment of their Exchange Act claims. To bind the Epstein plaintiffs to the Delaware judgment under these circumstances would violate their due process right to have their interests adequately represented at all times.

III

The Epstein plaintiffs also contend that we may withhold full faith and credit from the Delaware judgment because

the Vice Chancellor did not adequately supervise the settlement proceedings. They argue that adequacy of judicial supervision is intricately bound up with adequacy of representation and, hence, that it rises to the level of a due process requirement. *See* Appellants' Br. at 31-37. In effect, they argue that we should add adequacy of judicial supervision to the four safeguards that *Shutts* guarantees to absent class members.

The Epstein plaintiffs cite no authority for their argument, however. They merely point us to various cases, including *Epstein I*, that have spoken in general terms about the importance of the court's role in supervising a class action proceeding. *See Epstein I*, 50 F.3d at 667; *In re General Motors Pick-Up Fuel Tank Prod. Liab. Litigation*, 55 F.3d 768, 805 (3d Cir.), *cert. denied*, 116 S. Ct. 88 (1995) (describing "fiduciary responsibility" of courts in class actions); *Prezant*, 636 A.2d at 921 (stressing "fiduciary nature of the class action"). Because we hold that the absent class members were denied due process because of inadequate representation, we need not reach this novel constitutional question.

CONCLUSION

Our decision that the Delaware judgment deprived the Epstein plaintiffs of their due process rights to adequate representation is the product of an extraordinary set of circumstances. Delaware counsel suffered from a conflict of interest: they could not litigate the Exchange Act claims of the absent class members, could not extinguish those claims by the issue preclusive effect of a judgment based

upon the state claims, and were in competition with a parallel class action in federal court which threatened to destroy their chances of securing a fee. Not surprisingly, their conduct in the Delaware action reflected this disabling conflict. Delaware counsel disparaged the Exchange Act claims of their own clients at every turn — to the clients themselves, to their adversaries, and even to the Chancery Court.

These extraordinary circumstances provide a sufficient answer to Matsushita's concern that our decision will pose a grave threat to the finality of class action judgments. The reality of the matter is that it is the rare exception for representation in a class action even to approach the point where an absentee will have a colorable claim for inadequacy. The small handful of cases that have come to our attention in which absentees have successfully challenged adequacy of representation bears this observation out. The paucity of such cases is to be expected. With rare exceptions, trial judges do their jobs and certify class representatives capable of representing the interests of absent class members. And, again with rare exceptions, the class representatives (including their counsel) faithfully discharge their fiduciary duties to the class. This case presents one of those rare exceptions.

We REVERSE the judgment and REMAND for proceedings consistent with Parts I, II, III, V & VI of *Epstein I*.

Appendix B

Epstein v. MCA, Inc., No. 92-55675

O'SCANNLAIN, Circuit Judge, dissenting:

Because I wholeheartedly agree with the Supreme Court's determination that the adequacy of representation issue was fully and fairly litigated and necessarily decided in the Delaware courts, I must respectfully dissent from the opinion this court announces today. In fashioning its own version of the events as they unfolded before the Delaware courts, the majority posits that the plaintiffs' adequacy claims were neither "actually litigated" before the Chancery Court nor "finally decided" by that court. With all deference, I believe that the undisputed facts tell a different story.

I

The argument urged upon us by the Epstein plaintiffs certainly engenders sympathy and has some force. Irrespective of whether the Delaware attorneys' conduct in the state court rose to the level of constitutional deprivation, their act of referring, in a single breath, to their own clients' claims as "fraught with uncertainty," "weak," and "horrendous" suggests less than dynamic advocacy. Regrettably, however, and unlike my colleagues, I do not believe that we are in a position to pass judgment on the merits of this appeal. The very issue presented to our court for decision today — whether or not the Epstein plaintiffs received constitutionally adequate representation in the Delaware courts — has been fully and fairly litigated before a state court of competent jurisdiction and finally decided by that court. Consequently, under the Full Faith and Credit Act, 28 U.S.C. § 1738, and the policies of federalism, comity, and finality that give it life, our court is not, in my mind, free simply to revisit the issue.

Appendix B

I do agree with my colleagues that the Supreme Court did not conclusively resolve the due process issue before it remanded the case to us. Indeed, as our court's opinion points out, the Supreme Court specifically disclaimed any interest in resolving the merits of the inadequacy claim. *See Matsushita Elec. Indus. Co. v. Epstein*, 116 S. Ct. 873, 880 n.5 (1996). However, the fact that the Supreme Court chose *not* to reach the due process challenge does not inexorably lead to the conclusion that this court *may* decide the issue. Quite the contrary, after reviewing the record, the Supreme Court concluded — in three separate passages and in no uncertain terms — that the Delaware courts had *already* conclusively resolved the due process issue. First, in Part I, in which it described the procedural posture of the case, the Court stated, rather matter-of-factly, that "[a]fter argument from several objectors, *the [Chancery] Court found the class representation adequate* . . . ." *Id.* at 876 (emphasis added). Several pages later, the Court reiterated its conclusion: citing the decisions of the Delaware courts approving the second MCA settlement, the Supreme Court specifically found that the Chancery Court, in accordance with Delaware Court of Chancery Rule 23, had "*determined* that the plaintiffs [,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *Id.* at 880 (quoting Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, C.A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 22, 1993)) (internal quotation marks omitted) (emphasis added). Finally, in its now famous footnote five, the Court expressed its skepticism at plaintiffs' decision even to press the due process issue "*in spite of the Chancery Court's express ruling*, following argument on the issue, that the class representatives fairly and adequately

protected the interests of the class." *Id.* at 880 n.5 (emphasis added).

Consequently, it is scarcely debatable that in the eyes of the Supreme Court, the Epstein plaintiffs' due process challenge was presented to and rejected by the Delaware state courts. The trouble, I suppose, is that the majority and the Supreme Court do not share the same vision.

A

In support of its "no-actual-litigation" argument, the majority first complains that, despite the fact that the form of notice sent to class members explicitly provided the rights to opt out and to object,[1] that notice "said nothing about adequacy of representation." Slip Op. at 11. Of course, the first, most obvious, and most decisive response to the majority's complaint is that the doctrine of collateral estoppel simply does not demand that an issue be actually *noticed for* argument, only that it be actually *litigated at* argument. *See, e.g., Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del. 1995) ("The test for applying collateral estoppel requires that (1) a question of fact essential to the judgment, (2) be litigated and (3) determined (4) by a valid and final judgment." (quoting *Taylor v. State*, 402 A.2d 373, 375 (Del. 1979))). Secondly, even if lack of notice were somehow independently

1. A number of the class plaintiffs exercised their procedural rights pursuant to the notice: eighteen shareholders opted out of the class, and three class members appeared in the Delaware Chancery Court to object to the settlement. *See In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43204, at *3 (Del. Ch. Feb. 16, 1993).

relevant to a proper collateral estoppel analysis, the court's no-notice argument fails to account for the fact that the form of notice mailed to each of the class members detailed the precise terms of the settlement. The very terms of that settlement — so pungently characterized by the majority as "a bare 2¢ a share, *inclusive* of attorneys' fees" and a release of all claims, state and federal — are *prima facie* evidence that something was amiss. *See* Slip Op. at 46. That fact — that the settlement *on its face* raises eyebrows — was no less true on October 27, 1992, when the notice was mailed, than our court finds it today. Consequently, the Epstein plaintiffs "were not forced into a position of having to predict whether their interests would be adequately represented. They could determine whether there had been adequate representation of their interests by reviewing the terms of the settlement." *Marshall v. Holiday Magic, Inc.*, 550 F.2d 1173, 1177 (9th Cir. 1977); *accord In re Four Seasons Sec. Laws Litig.*, 502 F.2d 834, 843 (10th Cir. 1974). They knew that they could object in the Delaware courts to the settlement, and, by implication, to the representation that had produced the settlement; they simply declined to do so.[2]

Closer to the heart of the appropriate collateral estoppel standard, the court claims — inexplicably, in my view — that the objectors who did elect to appear at the settlement hearing did not "actually litigate" the adequacy of their representation. To the contrary, one of the objectors, William

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2. I might add that the Epstein plaintiffs' counsel's candid admission to the Supreme Court that his clients stayed out of the Delaware proceedings for purely strategic reasons, *see infra* pages 10 - 11, is conclusive proof that any perceived notice failure was illusory.

Krupman, explicitly stated (as the majority itself acknowledges) that he opposed the settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their own attorneys. *They did not provide adequate representation to the class.*" Affidavit of William A. Krupman at 2 - 3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993) (emphasis added). The majority attempts to cushion the blow of Mr. Krupman's explicit statement by accusing it of "conflating the non-constitutional question of the fairness of the settlement with the constitutional question of the adequacy of representation." Slip Op. at 12. Its criticism, however, rings particularly hollow for one salient reason, alluded to briefly above: the court's *own* conclusion of inadequacy rests substantially on precisely the same logic, namely, that, *under the terms of the settlement*, the Delaware plaintiffs' attorneys who profited so well did so at the expense of their class-member clients. *See generally* Slip Op. at 37 - 52.

The majority dismisses the arguments of another of the objectors, Pamela Minton de Ruiz, out of hand because she failed to use the magic word "inadequacy." Rather, the court notes, Minton de Ruiz "framed her objection in terms of *collusion*." Slip Op. at 12 (emphasis added). The court simply brushes Minton de Ruiz's objection aside because, it complains, she did not "focus[ ] on the much broader issue of whether representation was constitutionally adequate." Slip Op. at 12. Formalistic labels and logic games[3] aside,

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3. The majority would have us read Minton de Ruiz's objection as if it belonged in a Venn diagram: "All collusion is inadequacy; some inadequacy is collusion . . . ."

however, it appears that the court has either failed to recognize *for* itself or failed *to* admit to itself that the Epstein plaintiffs bottom their inadequacy of representation argument on virtually the identical factual predicate upon which Minton de Ruiz based her "collusion" objection. For instance, the Delaware Chancery Court characterized Minton de Ruiz's argument in the following terms:

> She argues . . . that the Delaware plaintiffs have colluded with the defendants to settle this action and dispose of the supposedly meritorious federal claims in exchange for an award of attorneys' fees and a de minimis benefit to the class.

In re MCA, Inc. Shareholders Litig., Civ. A. No. 11740, 1993 WL 43024, at *3 (Del. Ch. Feb. 16, 1993). When one compares Minton de Ruiz's contention with one of the plaintiffs' central arguments from their opening brief in this appeal, the perceived distinction between "inadequacy of representation" and "collusion" quickly begins to fade:

> *Delaware counsel — paid only on a contingency basis — had no incentive other than to "compromise" other litigants' substantial federal claims.* Counsel knew that, if they settled the federal claim they would get paid; if they attempted to litigate, they would get nothing. Such a one-sided incentive structure is surely a constitutionally disabling conflict of interest . . . .

Appellants' Opening Brief at 27 (emphasis in original). And once one recognizes that even this court's *own* inadequacy

holding invokes the very same attorney-client antagonism, the majority's effort to obscure substantive identity in semantic minutiae is laid bare:

> Matsushita . . . knew that class counsel had an extraordinary incentive to settle and settle *quickly* because that was the *only* way they could extract a fee out of the federal claims.
>
> . . . .
>
> . . . Indeed, the misalignment of interests and incentives between class counsel and their clients in these circumstances was so great that it is fair to say that counsel's interests were more in line with the interests of Matsushita than those of their clients.

Slip Op. at 37 - 38 (emphasis in original). In sum, try as it may to "label away" objector Minton de Ruiz's argument, the fact remains that a rose by any other name is still a rose: in this case, as the court's opinion amply demonstrates, the primary reason that the class representatives were alleged to have been *inadequate* was the self-interested and, dare I say, *collusive*, conduct of the Delaware class attorneys.

B

In addition to holding that the inadequacy issue was not "actually litigated" in the Delaware system, this court cites *Prezant v. De Angelis*, 636 A.2d 915 (Del. 1994), and suggests that the Delaware courts did not "finally determine"

the question of inadequacy in a manner consistent with Delaware law. Slip Op. at 13 n.6. Again, I must agree with the United States Supreme Court's assessment that the available evidence counsels otherwise. In *Prezant*, the Delaware Supreme Court announced the following holding: "[I]n every class action settlement, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and (b)," including the mandate that class representation was adequate. *Prezant*, 636 A.2d at 925. Contrary to the majority's suggestion, the Vice Chancellor in this case specifically made the "explicit determination" contemplated by *Prezant*, when he declared that "it is . . . hereby determined that the plaintiffs in the Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Class . . . ." Order and Final Judgment at 2, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 22, 1993). His "determination," I submit, could not have been more "explicit." What is more, the Delaware Supreme Court — the *very court* that issued the *Prezant* guidelines — entertained additional argument on the inadequacy matter, and expressly and unanimously affirmed the Chancery Court's determination that the class had been adequately represented. *See In re MCA, Inc. Shareholders Litig.*, No. 126,1993, 1993 WL 385041, at *1 (Del. Sept. 21, 1993).[4]

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4. The majority accuses the Delaware Chancery Court of failing properly to support its conclusion of adequacy, citing language from the *Prezant* opinion suggesting that a court should "articulate on the record its findings regarding the satisfaction of the Rule 23 criteria and supporting reasoning in order to facilitate appellate

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In sum, I conclude, as did the United States Supreme Court, that the question of adequate representation (1) was actually litigated before the Delaware Chancery Court and (2) was decided by that court in a valid and final judgment. Although the plaintiffs in this action were not themselves present before the Vice Chancellor, their grievances were ably litigated through their surrogates, objectors Krupman and Minton de Ruiz. Moreover, as the settlement notice made explicit, the plaintiffs themselves were presented with a "full and fair opportunity" to participate personally in the settlement hearing if they so desired. Consequently, under long-established principles of Delaware preclusion law, I believe that the Delaware courts would give collateral estoppel effect to the Chancery Court's judgment and would forbid plaintiffs from relitigating the merits of the inadequacy issue. *See Messick v. Star Enter.*, 655 A.2d 1209, 1211 (Del.

(Cont'd)
review." *Prezant*, 636 A.2d at 925. Even if I believed that the quoted language represented the holding of the Delaware Supreme Court — which I do not, *see Goodrich v. E.F. Hutton Group, Inc.*, 681 A.2d 1039, 1045 (Del. 1996) (reaffirming that the "essential" requirement recognized in *Prezant* is "a judicial determination that the adequate representation requirement of Rule 23(a)(4) has been satisfied") — I believe that the Chancery Court discharged its responsibility of articulating the reasons for its holding; it found that although the objectors had alleged that the settlement was collusive, "[s]uspicion . . . is not enough." *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024, at *5 (Del. Ch. Feb. 16, 1993); *see also Youngman v. Tahmoush*, 457 A.2d 376, 381 (Del. Ch. 1983) (suggesting that, under Delaware law, the party challenging the adequacy of the class members' representation bears the burden of demonstrating inadequacy). That finding was specifically affirmed by the Delaware Supreme Court.

1995); *Evans v. Frank E. Basil, Inc.*, 1986 WL 3973, at *2 (Del. Super. Ct. Mar. 20, 1986). Pursuant to the plain — and now universally acknowledged — meaning of the Full Faith and Credit Act, 28 U.S.C. § 1738, we must do the same. *See Matsushita*, 116 S. Ct. at 877 ("The Act . . . directs all courts to treat a state court judgment with the same respect it would receive in the courts of the rendering state."); *accord Marrese v. American Academy of Orthopedic Surgeons*, 470 U.S. 373, 380 (1985); *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 81 (1984); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481 - 82 (1982); *Allen v. McCurry*, 449 U.S. 90, 96 (1980).

II

As to the majority's last-gasp invocation of *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), to deny the Delaware judgment issue preclusive effect, I most emphatically protest. The court cites *Shutts* in support of its per se rule that class settlement objectors — such as Krupman and Minton de Ruiz — may never, consistent with the Due Process Clause, finally litigate absent class plaintiffs' rights to adequate representation. *Shutts* simply cannot, in my view, bear the weight of such an extreme interpretation.[5] The concerns that impelled the *Shutts* Court's recognition of the prerogative of absent plaintiffs generally to "sit back and allow the litigation to run its course," *Shutts*, 472 U.S. at 810, plainly are not in play in this case.

---

5. It is certainly worthy of note, in this respect, that the majority itself recognizes that the Third Circuit's recent, post-*Shutts*, decision in *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (3d Cir. 1994), patently rejects such view. Slip Op. at 15.

Appendix B

The *Shutts* Court was motivated by a concern for fairness to parties who, without the right to "sit back," might be forced to forfeit their claims altogether. The *Shutts* Court found that in light of financial constraints, some plaintiffs, if forced to litigate their own claims, might "have no realistic day in court." *Id.* at 809. However, as the following colloquy, which occurred during oral argument before the Supreme Court, makes clear, the Epstein plaintiffs (quite unlike the "absent" class plaintiffs in *Shutts*) absented themselves from the Delaware fairness hearing not for *financial* reasons, but for *tactical* reasons:

> [COURT]: What about the argument that you should have come into Delaware to make [the inadequacy of representation] objection and not stayed out of it?
>
> [COUNSEL]: . . . If we stayed out . . . we knew that we could make collaterally the attack on lack of adequate representation [and] due process . . . .

Transcript of Oral Argument at 47, *Matsushita Elec. Indus. Co. v. Epstein*, 116 S. Ct. 873 (1996) (No. 94-1809). What is more, the Epstein plaintiffs lost absolutely nothing by not attending the settlement hearing. As they sat idly by, content in the notion that they had preserved their right collaterally to attack the Delaware judgment, their substantive arguments were, as detailed above, simultaneously being presented by objectors Krupman and Minton de Ruiz. (Indeed, this fact very likely was known to the Epstein lawyers, in light of objector Krupman's lawyer's admission that his client's

objection had originally been drafted by the attorneys representing the Epstein plaintiffs.)

The Epstein plaintiffs have managed, quite literally, to have their cake and eat it too. They now get two bites at the proverbial apple. Today, this court not only *condones* such gluttony, it *constitutionalizes* it. We are constantly reminded that "no single model of procedural fairness, let alone a particular form of procedure, is dictated by the Due Process Clause." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 483 (1982). Rather, "due process is flexible and calls for such procedural protections as the particular situation demands." *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). For the court to have co-opted the salutary principle announced in *Shutts* and applied it in rote fashion to the facts of this case undermines, in my view, the very concept of due process of law.

III

The majority seeks to hush Matsushita's "alarmist cry" that the opinion announced today "will sound the death knell to finality in class actions if individual objectors cannot bind absentees on the issue of adequate representation." Slip Op. at 15. The court rejects Matsushita's argument as "hyperbole." Slip Op. at 15. To allay Matsushita's fears, the court directs its attention to the following passage in the Delaware Supreme Court's opinion in *Prezant*:

> [The approach we announce today] will serve to benefit both class members and defendants. Class members . . . will . . . have their interests

> protected by the requirement that their claims cannot be compromised without . . . a judicial determination that the Rule 23 criteria have been satisfied . . . . Such a determination will include a finding that their due process right to adequate representation has in fact been satisfied. Defendants will be protected from a possible collateral attack on the validity of the settlement by a class member claiming the settlement did not meet the requirements of Rule 23. This protection will help insure that the final release sought by defendants in settlements is indeed final.

Prezant, 636 A.2d at 925 - 26. I sincerely doubt that the court's reassurance is of any consolation whatsoever to Matsushita or to other potential class action defendants. If anything, it is a source of consternation. Matsushita, after all, did precisely what the *Prezant* court (and now this court) instructed it to do: It asked for and got a judicial finding — an "express ruling," in the words of the United States Supreme Court — that the representation of the plaintiff class had been constitutionally adequate. Curiously, today this court tells both Matsushita and the Delaware judiciary that, alas, they did not do enough.

Because I believe that today's decision not only threatens finality, but also contravenes "the elementary principles of federalism and comity," *Growe v. Emison*, 507 U.S. 25, 35 (1993), that animate the Full Faith and Credit Act, I respectfully dissent.

APPENDIX C — MEMORANDUM OPINION OF THE COURT OF CHANCERY OF DELAWARE, NEW CASTLE COUNTY DATED AND FILED FEBRUARY 16, 1993

In re MCA, INC. SHAREHOLDERS LITIGATION.

Civ. A. No. 11740.

Court of Chancery of Delaware, New Castle County.

Submitted: Jan. 21, 1993.

Filed: Feb. 16, 1993.

* * *

MEMORANDUM OPINION

HARTNETT, Vice Chancellor.

After considering all the circumstances, the Court in its business judgment approves the settlement of this class action. That has the effect of barring related federal securities law claims that have been filed in federal district court in California. The settlement is approved because the Court finds, on balance, that it is in the best interests of the class to settle this litigation and the terms of the settlement are fair and reasonable — although the value of the benefit to the class is meager.

Appendix C

This decision also awards attorneys' fees to the attorneys for plaintiffs in an amount less than that sought.

I

This is the second time a proposed settlement of this class action has come before this Court. The facts appear in greater detail in this Court's previous opinion in which the initial proposed settlement was rejected. See In re MCA, Inc. Shareholders Litigation, Del.Ch., 598 A.2d 687 (1991).

In September of 1990, Matsushita Electrical Industrial Co., Ltd. ("Matsushita") and MCA, Inc. publicly announced that they were negotiating a possible acquisition of MCA by Matsushita. During the next two days, three purported class action suits were filed against MCA and its directors. Notwithstanding that no acquisition agreement had been reached, the complaints alleged that the defendants had breached their fiduciary duty to the shareholders by failing to implement a market check procedure to ensure that maximum shareholder value was realized. These actions were consolidated by an Order of this Court dated October 2, 1990.

On November 26, 1990, MCA and Matsushita announced that they had entered into a Merger Agreement. Under the Merger Agreement, Matsushita agreed to make a cash tender offer for all of MCA's outstanding shares at $66 per share and agreed to spin off Pinelands, an MCA subsidiary, which controlled a television station which Matsushita, under federal law, was forbidden to acquire.

On December 3, 1990, a purported class action was filed in the United States District Court for the Central District of

California as Epstein v. MCA, Inc. et al., No. CV-90-6451-R ("the Epstein action"). The Epstein action alleged that the tender offer included a special deal for the acquisition of the approximately 5 million shares of MCA held by Lew R. Wasserman, MCA's chairman and CEO. Wasserman had agreed with Matsushita to exchange his shares for a special class of preferred stock in a Matsushita subsidiary.

The complaint in the Epstein action alleged that this transaction violated SEC Rule 10b-13, 17 C.F.R. 240.10b-13, that prohibits purchases by a tender offeror outside a tender offer during the pendency of the offer and also violated the "all holders, best price" rule in SEC Rule 14d-10, 17 C.F.R. 240.14d-10. Four additional purported class actions alleging similar claims were also filed in the California Federal District Court and were consolidated by Order of the District Court on April 1, 1991.

The plaintiffs in this Delaware action amended their complaint on December 14, 1990 to allege that the tender offer materials failed to disclose the preferential treatment allegedly given to Wasserman. The amended complaint also named Matsushita as a defendant since it allegedly aided and abetted MCA in a breach of fiduciary duty by entering into the transaction with Wasserman. The amended complaint did not allege the breaches of federal securities laws asserted in the Epstein action, however, because such claims are within the exclusive jurisdiction of the federal courts.

On December 18, 1990, the parties in this Delaware action filed a Stipulation and Agreement of Compromise and Settlement and this Court provisionally certified the Class

pursuant to Chancery Rule 23(b)(2) for settlement purposes only. David and Andrew Minton (purported shareholders of MCA) entered an appearance and objected to the proposed settlement on the sole basis that the settlement, if approved, would release the claims asserted in the Epstein action without affording the members of the class the opportunity to opt out of the class and continue to press the claims in the Epstein action.

This Court held that while the proposed settlement need not provide for an opt-out, it could not be approved. This Court found that the claims asserted in this Delaware action were "at best, extremely weak, and therefore, ha[d] little or no value. It further found that the federal securities law claims in the California action raised issues that had not been definitively addressed by the courts and that those claims therefore clearly had arguable merit and, therefore, some value. MCA, 598 A.2d at 695. This Court observed that it must carefully scrutinize any settlement that would have the effect of barring claims of at least arguable merit that were not raised in Delaware litigations but were asserted elsewhere, particularly if a proposed settlement was of little or no value to the class. Id., (citing Selfe v. Joseph, Del.Supr., 501 A.2d 409 (1985)).

After this Court evaluated the proposed settlement under this standard, the settlement was rejected as being unfair to the class. Id. at 696. While the proposed settlement provided for a generous payment of up to $1 million in attorneys' fees, the only benefit proposed to be received by the class would have been a cosmetic change in a poison pill in Pinelands, a subsidiary of MCA. Id. at 695-96. In exchange

for this "illusionary" benefit, the class would surrender any potential benefits from the claims in the Epstein action which this Court found to be "the only claims which have any substantial merit . . . ". Id. at 696. Therefore, the proposed settlement was rejected.

On April 1, 1991, the California Federal District Court rejected the plaintiffs' motion for class certification in the Epstein action and a second motion for class certification was rejected on September 3, 1991. By Order dated August 13, 1991, the same court dismissed the SEC Rule 10b-13 claims on the basis that there is no private right of action under that provision. Finally, on February 10, 1992, the Federal District Court granted summary judgment to defendants on the SEC Rule 14d-10 claims on the basis that the Wasserman transaction did not take place within the tender offer period and that Wasserman did not receive a greater consideration than other shareholders. The Epstein plaintiffs have appealed these decisions to the United States Court of Appeals for the Ninth Circuit. On December 17, 1992, that court denied the request of the Epstein plaintiffs to expedite their appeal because of the pendency of the settlement in this Court.

The parties in this Delaware action have now submitted a second settlement proposal. If this proposed settlement is approved, the class will receive $2,000,000 in cash less any award of attorneys' fees. Any class member dissatisfied with the settlement may opt out of the class. This settlement, like the previous proposed settlement, is a "global settlement;" that is, it would bar not just the claims asserted in this Delaware action but all related claims such as those asserted in the Epstein action.

Appendix C

At the settlement hearing, counsel for the plaintiffs in this Delaware action reported that 18 class members had opted out of the class. In addition, objections to the proposed settlement were received from three class members.

Pamela Minton de Ruiz, daughter of one of the Epstein plaintiffs, objected on the basis that the settlement is collusive. She argues, without any direct evidence of collusion, that the Delaware plaintiffs have colluded with the defendants to settle this action and dispose of the supposedly meritorious federal claims in exchange for an award of attorneys' fees and a de minimis benefit to the class. She argues that the opt out is virtually meaningless because, as a practical matter, "few shareholders will avail themselves of it". She makes this argument despite that her brothers, David and Andrew Minton, as objectors to the first proposed settlement, strongly argued in favor of the same opt-out provision.

Objector William A. Krupman makes arguments similar to those made by Pamela Minton. Objector Marion Minton, wife of one of the Epstein plaintiffs, also objects to the adequacy of the notice of the settlement given to members of the class because Dean Witter apparently delayed transmitting the notice of the settlement hearing to the owners of shares held in street name by Dean Witter.

II

Chancery Rule 23(e) requires that the Court review proposed settlements of class action suits. The rule is "intended to guard against surreptitious buy-outs of

representative plaintiffs, leaving other class members without recourse." Wied v. Valhi, Inc., Del.Supr., 466 A.2d 9, 15 (1983), cert. denied, 465 U.S. 1026 (1984). This Court must be particularly careful in reviewing a proposed settlement that has the effect of barring claims of at least arguable merit that are not asserted in Delaware but are being asserted in another forum. MCA, 598 A.2d at 695; see also, John C. Coffee, Jr., "Suspect Settlements In Securities Litigation" N.Y.L.J., March 28, 1991, p. 5.

This Court's role in reviewing a proposed settlement is to exercise its discretion and to "apply its own business judgment in deciding whether the settlement is reasonable . . .". Polk v. Good, Del.Supr., 507 A.2d 531, 535 (1986). The factors to be considered in making this determination include:

> (1) the probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectability of any judgment recovered, (4) the delay, expense and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectability of a judgment, and (6) the views of the parties involved, pro and con. Id. at 536 (citations omitted).

Particular attention must be paid to balancing the value of all the claims being compromised against the value of the benefit to be conferred on the class. MCA, 598 A.2d at 691. After weighing the factors present here, the Court concludes that this settlement, notwithstanding that it has meager value

to the class, should be approved as being in the best interests of the class.

As noted in the previous opinion in this case, the claims brought in this Delaware action were "extremely weak and, therefore, have little or no value." Id. at 694. At that time, the federal claims had not been litigated and raised issues which had not been "definitively addressed by the courts." Id. at 695. This Court therefore was reluctant to approve the settlement that would compromise those claims, despite their somewhat limited merit, particularly when the benefit to be received in exchange was of "illusionary" value to the class. Id. at 696.

Now, however, there has been a full hearing on the federal claims and those claims have been rejected on both legal and factual grounds in the U.S. District Court. The Objectors claim that these rulings are erroneous and that there is at least a chance that they will be reversed in a pending appeal. These federal claims, however, obviously now have less economic value than they had before their dismissal.

In determining whether a settlement should be approved, a court should not try the merits of the underlying claims. MCA, 598 A.2d at 691. This principle would seem to be especially appropriate where the underlying claims, like the federal claims here, are outside the jurisdiction of this Court.

It is sufficient that the determination of the federal district court that the claims lack merit must be accorded substantial weight in determining the present settlement value of those claims.

Appendix C

In exchange for surrendering the weak claims asserted in this Delaware action and the federal claims which, in light of the adverse federal district court decision, now have greatly diminished settlement value, the class will receive a $2 million cash settlement (less any award of attorneys' fees). As the Objectors point out, this amounts to only two to three cents per share. While not a munificent recovery, on balance, the Court finds in its business judgment that it is adequate (if only barely so) to support the proposed settlement.

This conclusion is based on the Court's conclusion that the claims on appeal from the federal district court now have minimal economic value and that there is a provision to opt-out of the settlement although only eighteen requests for opt-outs were received from the more than 25,000 shareholders notified.

The availability of the right to opt-out of the class protects the ability of class members who find the proposed settlement inadequate to continue the district court litigation.

The three Objectors assert, without citing any empirical evidence, that because, as a practical matter, few small shareholders will ever opt-out of a settlement, the proposed settlement will in effect destroy the Epstein action as a class action. This argument comes from an unexpected source because the Mintons (two of the three Objectors to this settlement) objected to the first proposed settlement solely on the grounds that it did not incorporate an opt-out provision. In any case, this Court's role is to evaluate the economic value of the settlement in its business judgment and not to speculate on why shareholders opt-out of class actions.

Appendix C

The Objectors also argue that this Court should delay its ruling until the Ninth Circuit renders its decision on the appeal of the Epstein action. This Court is most reluctant to take any action that could be construed as attempting to interfer with the appellate process in the federal courts. However, as noted above, the Ninth Circuit denied the Epstein plaintiffs' motion for expedited argument after being advised of the proposed settlement hearing in this Court and there is no indication of when that court might rule. If this Court rejects the settlement, the $2 million dollar benefit will vanish.

The law favors voluntary settlements. In re Resorts International Shareholders Litigation Appeals, Del.Supr., 570 A.2d 259, 265-66 (1990). Unless fair settlements are promptly approved, the settlement process will be adversely impacted. Therefore, the Objectors' request that this Court indefinitely delay its review of the settlement must be denied.

Objector Marion Minton also objects to the settlement on the basis that many shareholders whose shares were held in "street names" by Dean Witter did not receive timely notice. However, the uncontradicted evidence is that the responsibility for any delay rests with Dean Witter. A shareholder who holds her shares in a "street name" assumes responsibility for any delays in notice that are attributable to the delay attendant in forwarding notice through the "street name". Enstar v. Senouf, Del.Supr., 535 A.2d 1351, 1354-55 (1987). Nonetheless, as a matter of equity, the proposed order implementing this opinion shall be amended to provide that any opt-outs received after the deadline set forth in the settlement notice but before the date of this decision will be effective.

Finally, the Objectors argue that the proposed settlement is collusive. They argue that the defendants "cut a deal" with the plaintiffs and their attorneys in this Delaware action to achieve a settlement of the federal claims which plaintiffs and their attorneys in this litigation were unable to assert (but can only settle) instead of negotiating with the Epstein plaintiffs and their attorneys whom they allege understand the true fair value of those federal claims.

The potential for this type of abuse clearly exists in representative litigation. See Stepak v. Tracinda Corp., Del.Ch., C.A. No. 8457-NC, Allen, C. (Aug. 18, 1989), slip op. at 15-16. And when the settling parties have previously proposed a patently inadequate settlement in which the class would have received no monetary benefit but the attorneys would have received $1 million in fees (as the initial, now-rejected, settlement provided), suspicions abound. Suspicion, however, is not enough and the Objectors have offered no evidence of any collusion. The proposed settlement must therefore be approved.

III

Plaintiffs' attorneys have applied for a total of $691,057.68 in attorneys' fees and expenses which represents approximately 35% of the settlement fund of $2 million.

The law governing the award of attorneys' fees in corporate litigation is well-established in Delaware. Where the efforts of a plaintiff on behalf of the stockholders of a corporation result in the creation of a common fund or the conferring of a corporate benefit, the Court may, in its

discretion, award attorneys' fees. Tandycrafts, Inc. v. Initio Partners, Del.Supr., 562 A.2d 1162, 1164 (1989).

The factor usually accorded the greatest weight in a discretionary award of attorney fees is the benefit produced by the litigation. I/M of the Appraisal of Shell Oil Co., Del.Ch., C.A. No. 8080-NC, Hartnett, V.C. (Oct. 30, 1992); In re Maxxam Group, Inc. Stockholders Litigation, Del.Ch., C.A. No. 8636-NC, Allen, C. (Apr. 16, 1987), slip op. at 31. "In many, perhaps most, cases it will be clear that the entire benefit is directly and entirely attributable to the litigation." Id. However, if the Court determines that the benefit was partly caused by the shareholder litigation and partly caused by the activities of others the award of attorneys' fees will be reduced. Id. at 31-34; Aaron v. Parsons, Del.Supr., 144 A.2d 155 (1958); Dow Jones & Co. v. Shields (In re Telerate, Inc. Shareholders Litigation), Del.Ch., C.A. No. 11,115-NC, Hartnett, V.C. (March 4, 1992).

In this litigation, the defendants' willingness to create the settlement fund seems likely to have been motivated as much by their concern as to their potential liability under the federal claims as by their concern for liability under the state law claims which this Court characterized as "extremely weak". MCA, 598 A.2d 694. Therefore, although this Delaware action may be the vehicle under which the more meritorious federal claims are settled, this does not mean that the Delaware action was entirely responsible for the benefits produced.

Even if this litigation was responsible for the production of the entire settlement fund, plaintiffs' application for 35%

of that fund is excessive considering the factors set forth in Sugarland Industries, Inc. v. Thomas, Del.Supr., 420 A.2d 142 (1980). In addition to the value of the benefit, this Court must also consider the stage at which the litigation was concluded and the amount of work necessary to produce the benefit. I/M of the Appraisal of Shell Oil Co., Del.Ch., C.A. No. 8080-NC (Consolidated), Hartnett, V.C. (Oct. 30, 1992), slip op. at 19-20 (citing Sugarland Industries, Inc. v. Thomas, Del.Supr., 420 A.2d 142 (1980)). While plaintiffs' counsel allegedly expended in excess of 3,300 hours in connection with this litigation, in cases involving shareholder litigation similar to this action, "[t]his Court has properly awarded much less than 25% of the benefit, especially where cases have been settled long before trial." Id. at 20 (citations omitted).

Ultimately, the amount of attorneys' fees that should be awarded is left to the informed discretion of this Court. See Tandycrafts, Inc. v. Initio Partners, Del.Supr., 562 A.2d 1162, 1166 (Chancery Court has "plenary power" over allowance of attorneys' fees). Having considered all the factors discussed in Sugarland, especially the meager benefit achieved by the litigation, the stage at which the proceeding was ended, the time and effort of counsel, the relative complexities of the litigation, the contingency factor and the standing and ability of counsel — I find that plaintiffs should be awarded a total of $250,000 in attorneys' fees and expenses.

IV

The settling parties shall submit an amended proposed order.

APPENDIX D — EXCERPTS FROM OFFICIAL TRANSCRIPT PROCEEDINGS OF THE SUPREME COURT OF THE UNITED STATES DATED NOVEMBER 27, 1995

IN THE SUPREME COURT OF THE UNITED STATES

No. 94-1809

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., ET AL.,

Petitioners

v.

LAWRENCE EPSTEIN, ET AL.

Washington, D.C.
Monday, November 27, 1995

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:03 a.m.

* * *

[3] PROCEEDINGS

(11:03 a.m.)

* * *

Appendix D

ORAL ARGUMENT OF BARRY R. OSTRAGER ON BEHALF OF THE PETITIONERS

MR. OSTRAGER: Mr. Chief Justice and may it please the Court:

* * *

[4] * * *

QUESTION: Subject to due process, though, is that not right? No full faith and credit if there's been no due process in the rendition of the judgment.

MR. OSTRAGER: Yes, Your Honor, and in addition the Marrese test indicates that full faith and credit must be granted unless there is an express or implied repeal by the after-enacted statute.

* * *

[7] * * *

QUESTION: So you say that any court, looking at the record that was made on the adequacy of representation here, would conclude on that record that the representation was adequate.

You agree with me, do you not, that it is the representatives' burden to show the adequacy and not the objectors' burden to show the inadequacy?

MR. OSTRAGER: We believe that it is for the [8] court before whom the case is pending, consistent with Rule 23 procedure, to make a determination concerning the adequacy of representation.

QUESTION: Who has the burden under Rule 23?

MR. OSTRAGER: I believe it would be the class representatives, and I believe it important to know that in this case, in which the adequacy of representation was actually litigated, the respondents in this case were not the type of sideline-sitters who were referred to by Justice Stevens in his dissent in Martin v. Wilkes.

* * *

[22] * * *

QUESTION: Mr. Monaghan, the question presented in the petition for certiorari is whether a Federal court [23] can withhold full faith and credit from a State court final judgment approving a class action settlement simply because the settlement included a release of exclusively Federal claims.

Respondents phrase the question, did the court below err in refusing to give preclusive effect to a Delaware settlement and release to the extent that the Federal claims were factually and legally unrelated to any State law claims.

No question of due process or adequacy is raised in the petition. You didn't cross-petition. This would be a totally alternate ground for affirmance.

MR. MONAGHAN: Your Honor, two points. I think first of all, we are respondents, and we can defend the judgment on any ground consistent with the record. This point was the central point of our argument below.

Secondly, even if we were in the petitioner's point of view, are in that position, this question is fairly included within the petition. The real question in the case — and they've reframed their question, incidentally, from their brief to their reply brief. The real question is, did the Ninth Circuit disregard erroneously what happened in Delaware?

QUESTION: Well, that certainly isn't the question — it's a much narrower question presented by the [24] petition, whether the State court can release Federal claims as well as State claims.

MR. MONAGHAN: It can't release those claims, Your Honor, if in doing so it would violate the Due Process Clause. They conceded that.

QUESTION: Well, that wasn't — the Ninth Circuit — the Ninth Circuit said they couldn't do it simply because State courts didn't have that authority.

MR. MONAGHAN: The Ninth —

QUESTION: And so I think, fairly understood, that was the question presented on certiorari.

MR. MONAGHAN: Well, I think — well, all I can say is, Your Honor, that whether or not that's the question that

they presented on certiorari, there was countless case law in this Court that we can defend a judgment —

QUESTION: Well —

MR. MONAGHAN: — on any ground consistent with the record.

QUESTION: — Mr. Monaghan, I think you're at some risk here today if you are unwilling to even argue the question on which cert was granted.

MR. MONAGHAN: Oh, I'm —

QUESTION: It's a question that I intend to deal with when I get to work on the case, and I would assume [25] you'd want to deal with it here —

MR. MONAGHAN: I —

QUESTION: — and not go off on some peripheral issues that aren't here.

* * * *

Supreme Court, U.S.
FILED
OCT 8 1999
OFFICE OF THE CLERK

No. 99-417

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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RULE 29.6 STATEMENT

Pursuant to Sup. Ct. R. 29.6, Respondent Matsushita Electric Industrial Co., Ltd. hereby states that it has no parent corporation and that no publicly held company owns 10% or more of its stock. Respondent Matsushita Holding Corp. hereby states that it is controlled by Matsushita Electric Industrial Co., Ltd. and that no other publicly held company owns 10% or more of its stock.

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Respondents Matsushita Electric Industrial Co., Ltd. and Matsushita Holding Corp. (collectively, "Matsushita") respectfully submit this brief in opposition to the petition for a writ of certiorari which seeks review of a June 7, 1999 decision of the United States Court of Appeals for the Ninth Circuit. That decision is reported at 179 F.3d 641 (9th Cir. 1999) and set forth in petitioners' appendix at App. 1a-31a. Petitioners' appendix did not include this Court's prior decision in this action. This Court's decision is reported at 516 U.S. 367 (1996) and set forth in respondents' appendix ("Resp't App.") at 1a-38a.

STATEMENT OF THE CASE

Petitioners have failed to meet their burden of demonstrating that a "compelling reason" exists for this Court to review this nine-year old case a *second* time. Sup. Ct. R. 10. Every issue raised in the petition has been (1) previously addressed in this Court's 1996 decision in this action and (2) adjudicated by the Delaware Chancery Court and Delaware Supreme Court in entering judgment upon the class action settlement at issue. The petition presents fact-intensive contentions that do not warrant another review because they involve highly unusual circumstances that are unlikely to recur. *See* App. 82a (Ninth Circuit observation in now-withdrawn 1997 opinion that this case presents "rare" circumstances and a "paucity of such cases is to be expected"); *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70, 74 (1955) (certiorari ordinarily will be denied if the case involves circumstances or issues which are unlikely to be repeated).

The Ninth Circuit's decision on remand simply implements this Court's ruling in this action, is consistent

with relevant precedent from this Court and other circuits, and presents no important federal question that should be resolved by this Court. *See* Sup. Ct. R. 10(a).

In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), this Court reversed the Ninth Circuit's 1995 decision that a Delaware class action judgment was not entitled to full faith and credit. After reviewing Delaware preclusion law and the factual record in the Delaware Chancery Court and the Delaware Supreme Court, this Court: (1) concluded that the Delaware courts possessed proper jurisdiction over the class action settlement, (2) held that the Delaware courts adjudicated the adequacy of representation issue petitioners seek to relitigate here, (3) found as a matter of Delaware law that "a Delaware court would afford preclusive effect to the settlement judgment in this case," and (4) held that because they chose not to opt out, petitioners "are bound, then, by the judgment" of the Delaware courts. *Matsushita*, Resp't App. at 12a-13a. The Ninth Circuit's decision enforces this Court's ruling by withdrawing a prior panel's decision on remand that effectively reinstated — by a two to one vote — the Ninth Circuit's 1995 decision which this Court had reversed.

Renewing an argument advanced before this Court in *Matsushita*, petitioners invite this Court on collateral review to find constitutional infirmity in the Delaware proceedings based on alleged inadequate representation. But as the most recent opinion of the Ninth Circuit correctly recognizes, "*Matsushita*'s holding was explicitly and implicitly premised upon the validity of the Delaware judgment." App. 8a. This Court specifically recognized that (1) the Delaware Chancery Court made an "express ruling, following argument on the issue, that the class representatives fairly and adequately

protected the interests of the class," and (2) "the Court of Chancery *found*, and the Delaware Supreme Court affirmed," that the requirements of due process were satisfied. *Matsushita*, Resp't App. 12a-13a & n.5 (emphasis added). And, as the Ninth Circuit stated, this "Court further noted that under Delaware law, a state court settlement of a class action could release or preclude claims only where that settlement was 'determined to be fair and to have met all due process requirements.' " App. 9a (quoting *Matsushita*, Resp't App. 11a). Petitioners know that adequacy of representation was fully litigated and decided because their counsel drafted objections to the adequacy of representation for another class member to present in Delaware. Resp't App. 46a.

Acknowledging that the Ninth Circuit's now-withdrawn decision on remand "did not give sufficient weight to these admonitions," Judge Wiggins' concurrence summarizes the consequence of the Delaware courts' determinations under principles of full faith and credit and issue preclusion:

> Because the adequacy of representation issue was fully and fairly litigated in the Chancery Court, the Delaware courts would give preclusive effect to that determination. . . . The Full Faith and Credit Act, 28 U.S.C. § 1738, requires that we "treat a state court judgment with the same respect that it would receive in the courts of the rendering state."

App. 22a (Wiggins, J., concurring) (quoting *Matsushita*, Resp't App. 5a-6a) (citation omitted).

There is no authority or policy that would permit a collateral attack based on allegedly inadequate representation

when, as this Court noted in *Matsushita*, Resp't App. 12a-13a, the class members were afforded notice, an opportunity to object or opt out, and the issue of adequacy of representation was actually litigated and resolved in state court. *See Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481 (1982) ("state proceedings need do no more than satisfy the minimal procedural requirements of the Fourteenth Amendment's Due Process Clause in order to qualify for the full faith and credit guaranteed by federal law"). Petitioners do not cite any case that even remotely supports *de novo* relitigation of a state court's adequacy determination in a federal court; instead, they rely on inapposite decisions concerning direct appeals. While petitioners now seek to manufacture an inconsistency between *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), and the Ninth Circuit's decision, they previously acknowledged in the Ninth Circuit that "*Shutts said nothing about collateral attack* on class actions for want of due process, including adequacy of representation." Plaintiffs-Appellants' Opening Brief on Class Action Issues at 41 (May 2, 1996) (emphasis added).

With actual notice of the proposed settlement and of the fairness hearing, petitioners sat out proceedings that determined the adequacy of representation while feeding arguments to objectors. This Court and the Delaware Supreme Court have held that under these circumstances petitioners have no "constitutional right" to collaterally attack the final class action judgment.

REASONS FOR DENYING THE WRIT

PETITIONERS PRESENT NO ISSUE WARRANTING A SECOND REVIEW BY THIS COURT

A. The Ninth Circuit's Decision Simply Implements This Court's Decision In This Action

In *Matsushita*, this Court held that "a Delaware court would afford preclusive effect to the settlement judgment in this case." Resp't App. 12a. The Full Faith and Credit Act "directs all courts to treat a state court judgment with the same respect that it would receive in the courts of the rendering state." *Id.* at 5a-6a. This Court observed that petitioners "do not deny that, as shareholders of MCA's common stock, they were part of the plaintiff class and that they never opted out." *Id.* at 13a. As a result, this Court held that petitioners "are bound, then, by the judgment." *Id.*

The Ninth Circuit's June 7, 1999 decision implements this Court's decision:

> [I]n *Matsushita*, any resolution of the preclusive effect to be afforded under Delaware law to the Delaware judgment necessarily entailed a determination of whether the judgment was "constitutionally infirm." If the judgment were constitutionally infirm, the judgment could not be binding under Delaware law, nor could a federal court accord it full faith and credit. *The Supreme Court's holding in Matsushita that under Delaware law the Epstein appellants were "bound, then, by the judgment," was thus necessarily premised upon the constitutional validity of the Delaware judgment.*

App. 11a (citation omitted) (emphasis added). The Ninth Circuit's decision properly acknowledges that compliance with due process was a necessary predicate for this Court's conclusion that a Delaware court would afford preclusive effect to the Delaware judgment. *See Prezant v. De Angelis*, 636 A.2d 915, 923 (Del. 1994) ("[T]his constitutional requirement [of adequate representation] is embodied in [Delaware] Rule 23(a)(4), which requires that the named plaintiff 'fairly and adequately protect the interests of the class.' "); *Hynson v. Drummond Coal Co.*, No. Civ. A. 7904-NC, 1997 WL 741507, at *1 (Del. Ch. Nov. 24, 1997) ("Class members are bound by a judgment only if their due process rights were protected.").[1]

Petitioners' grievances raise questions of fact previously litigated and decided in Delaware. The cornerstone of the petition is the inaccurate factual contention that "the Delaware court approved a class settlement without making *any* inquiry into adequacy of representation." Pet. at 10 (emphasis added). But as this Court specifically noted,

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1. As this Court previously observed, petitioners received notice of the Delaware proceedings, including their right to request exclusion from the settlement class and to object to the fairness of the settlement. *Matsushita*, Resp't App. 3a. Petitioners, however, chose not to opt out or object; instead, their lawyers drafted objections to the adequacy of representation for another class member to present in Delaware. Resp't App. 46a. As petitioners concede, *see* Pet. at 3, class members did, in fact, challenge both the adequacy of representation and the fairness of the settlement. The Delaware Chancery Court and the Delaware Supreme Court considered these issues, approved the class settlement, and entered a judgment releasing all claims. No class member, including petitioners, sought review under Delaware Chancery Rule 60(b) or in this Court under 28 U.S.C. § 1257. *See generally Matsushita*, Resp't App. 4a-5a.

petitioners previously asserted this claim "in spite of the Chancery Court's express ruling, following argument on the issue, that the class representatives fairly and adequately protected the interests of the class." *Matsushita*, Resp't App. 12a-13a n.5. Indeed, petitioners — through surrogate objectors — directly raised the adequacy of representation issue at the Delaware settlement hearing. As Judge Wiggins observed:

> One of the objectors, William Krupman, explicitly opposed the proposed settlement because "the purported class representatives . . . had proposed a settlement that benefitted no one but their attorneys. *They did not provide adequate representation to the class.*"

App. 21a-22a (quoting Affidavit of William A. Krupman at 2-3, *In re MCA, Inc. Shareholders Litig.*, Civ. A. No. 11740, 1993 WL 43024 (Del. Ch. Feb. 16, 1993)) (emphasis added by Wiggins, J.). Petitioners' counsel wrote the first draft of Mr. Krupman's objection. Resp't App. 46a.

The Delaware Chancery Court considered Mr. Krupman's objection and a "similar" objection by Pamela Minton de Ruiz, but approved the class action settlement because it found "the class representation adequate and the settlement fair." *Matsushita*, Resp't App. 3a; *see also* App. 22a (Wiggins, J.). The Delaware Supreme Court affirmed the vice chancellor's order, which, as petitioners concede, Pet. at 15, "recited that there was adequate representation." *See Matsushita*, Resp't App. 4a.[2]

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2. Petitioners' fact-intensive contention that the settlement was unfair because it undervalued the federal claims fails to recognize (Cont'd)

Ignoring these findings, petitioners argue that they are not bound by the Delaware judgment because "[o]bjectors are objectors, not class representatives." Pet. at 20. But if, as petitioners suggest, each class member is free to collaterally challenge a final judgment, there is no "class suit" — except one that is "one way" (*i.e.*, binding on the opposing party but not on the class). Moreover, petitioners misapprehend the source of the binding authority: it is the court's *determination* of the issues before it that binds the absent class members, not the identity of the party raising the argument. *See Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553, 1560-61 (3d Cir.), *cert. denied*, 513 U.S. 986 (1994). When an objector contests the adequacy of representation, with the absent class members' authorized representative participating on behalf of the class, absent class members are bound by any judgment properly rendered by the issuing court. *See, e.g., Williams v. General Elec. Capital Auto Lease, Inc.*, 159 F.3d 266, 275 (7th Cir. 1998), *cert. denied*, 119 S. Ct. 2392 (1999). This is particularly true of petitioners, who were virtual objectors because their alter ego made their arguments. As both this Court and the Ninth Circuit have held, petitioners' arguments concerning the adequacy of representation were made, listened to, and rejected.

(Cont'd)
that the settlement was reached *after* the federal district court had denied class certification and dismissed the case, *see* App. 6a, therefore making it logical to assign minimal value to those claims. Moreover, the Delaware Supreme Court is the "ultimate authority on matters of Delaware law," including the fairness of a settlement and the res judicata effect of settlement judgments. *See* App. 9a n.2 (citing *Matsushita*, Resp't App. 14a).

B. The Ninth Circuit's Decision Is Consistent With Precedent From This Court And Decisions From Other Circuit Courts Of Appeal

1. Kremer *Properly Defines The Limits Of Collateral Attack*

Under the guise of a due process challenge, petitioners seek to create a federal role in second guessing a state court finding of adequate representation in an opt-out class action settlement. But this Court has already thoroughly addressed the scope of permissible collateral attack on state court proceedings. In reviewing a state court judgment on collateral attack, a federal court may consider only whether the state court proceedings "satisf[ied] the minimum procedural requirements of the Fourteenth Amendment's Due Process Clause." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481 (1982). Under this clear standard — which this Court found applicable here, *see Matsushita*, Resp't App. 6a — a federal court is to consider only whether the state court *procedures* are adequate to ensure that the parties have a full and fair opportunity to litigate their claims; it does not permit a *de novo* review of the underlying facts or the merits of the adequacy of representation question itself.

Petitioners now assert that the Delaware judgment is not entitled to full faith and credit under *Kremer* because the Delaware procedures were, as a matter of fact, "fundamentally flawed." Pet. at 10. The petition, however, ignores this Court's findings that the procedures employed by the Delaware courts comported with due process. *See Matsushita*, Resp't App. 12a-13a. Indeed, this Court expressly recognized that the Delaware proceedings conformed with Delaware Chancery Rule 23, which is

substantially identical to Federal Rule of Civil Procedure 23. *Matsushita*, Resp't App. 12a-13a. And, it is well settled that Delaware Chancery Rule 23 and Federal Rule of Civil Procedure 23 codify the requirements of due process in class actions. *See id.* at 12a-13a n.5; *see also id.* at 34a (Ginsburg, J., concurring in part, dissenting in part) ("In Delaware, the constitutional due process requirement of adequate representation is embodied in Delaware Court of Chancery's Rule 23.").[3]

Petitioners then argue that they are entitled to a *de novo* review of the Delaware courts' findings because the class representatives had "no power to assert in any court" the federal claims at issue here. Pet. at 18. As an initial matter, this argument (which petitioners previously raised in this Court) is foreclosed by this Court's ruling in *Matsushita* that state court class representatives may release exclusively federal claims even though they cannot litigate them. Resp't App. 10a-11a. More importantly, *Kremer* prohibits a federal court on collateral review from conducting the kind of fact-sifting second guessing petitioners seek, where, as here, the minimal procedural requirements of due process were satisfied. *See Kremer*, 456 U.S. at 481-82.[4]

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3. Petitioners mischaracterize the Ninth Circuit's decision as holding that "[s]o long as the state has the functional equivalent of Rule 23, absent class members are bound by the class action judgment no matter how inadequate the representation." Pet. at 6, 11. The Ninth Circuit's decision does not conclude that the existence of Rule 23 was sufficient to bind class members — rather, it was the existence of Rule 23 together with the fact that "the Delaware Chancery Court made the requisite findings." App. 15a n.6 (citing *Matsushita*, Resp't App. 12a-13a).

4. Seeking to relitigate factual determinations made in Delaware, petitioners contend that there is no evidence that the class (Cont'd)

The *de novo* review standard on collateral attack sought by petitioners also would endanger the finality and utility of *all* class action settlements. *See* App. 15a (petitioners' theory would allow every class plaintiff a "largely unfettered right to challenge collaterally the adequacy of representation in class actions"); *Hynson*, 1997 WL 741507, at *1 (noting that an unfettered right to collaterally attack on due process grounds "would seriously undermine the utility of class actions"). Moreover, petitioners' suggestion that a federal court sitting in collateral review should be able to second guess a state court finding of adequacy collides with basic principles of federalism and "this Court's emphatic reaffirmation . . . of the constitutional obligation of the state courts to uphold federal law, and its expression of confidence in their ability to do so." *Allen v. McCurry*, 449 U.S. 90, 105 (1980).[5] In short "the absent class members' due process right

(Cont'd)
representatives "were even members of the class, or that they held any federal claims that were not barred by the statute of limitations." Pet. at 15. The amended Delaware class action complaint filed on December 14, 1990 specifically alleged, however, that the named plaintiffs were current owners of MCA common stock, which fits them squarely within the class definition, and this contention was uncontested. Resp't App. 50a-51a. The Delaware Chancery Court also specifically found that all the requirements of Rule 23(a) had been satisfied (which includes a requirement that the representatives have claims typical of the class) and that the representatives fairly and adequately represented the class members' interests. Resp't App. 40a.

5. The Ninth Circuit does not and cannot sit in direct review of the Delaware Supreme Court. *See Asarco Inc. v. Kadish*, 490 U.S. 605, 622-23 (1989); *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 476 (1983); *Rooker v. Fidelity Trust Co.*, 263 U.S. 413, 415 (1923); *see also Kamilewicz v. Bank of Boston Corp.*, 92 F.3d 506, 512 (7th Cir. 1996), *cert. denied*, 520 U.S. 1204 (1997).

to adequate representation is protected not by collateral review, but by the certifying court initially, and thereafter by appeal within the state system and by direct review in the United States Supreme Court." App. 16a. Petitioners chose to forgo these safeguards.

2. *Cases Cited By Petitioners In Which Absent Class Members Had No Opportunity To Appear, And Which Do Not Implicate The Full Faith And Credit Act Are, On Their Face, Inapplicable*

Attempting to manufacture a federal issue for review, petitioners allege that the Ninth Circuit's decision is in "direct conflict with an unbroken wall of authority in this Court from *Hansberry v. Lee* on down through *Amchem Products* and *Ortiz v. Fibreboard*." Pet. at 12. But the procedural due process concerns this Court addressed in *Hansberry v. Lee*, 311 U.S. 32 (1940), and *Richards v. Jefferson County, Alabama*, 517 U.S. 793 (1996), are not implicated here where it is undisputed that class representatives were approved pursuant to Delaware Rule 23 and that class members received notice, an opportunity to object, and the right to opt out. *See Hansberry*, 311 U.S. at 44 (finding that absent parties, who had no notice or opportunity to participate in a prior litigation, could not be bound where their alleged representatives had an actual conflict with the absent class members' interest); *Richards*, 517 U.S. at 802 (finding that a judgment in a prior non-representative action is not binding on individuals who "neither participated in, nor had the opportunity to participate in," the prior action) (internal citation omitted); *see also Blonder-Tongue Labs., Inc. v. University of Ill. Found.*, 402 U.S. 313, 329 (1971) (citing *Hansberry* for the proposition that litigants who "never had a chance to present their

evidence and arguments" in a prior action may not be bound by a prior judgment). Petitioners' reliance on this Court's decisions in *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295 (1999), and *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), is similarly misplaced because both involved direct appeals of class action settlements. Neither implicated the Full Faith and Credit Act or a collateral attack on a judgment.[6]

Petitioners' assertion that the Ninth Circuit's decision conflicts with *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), is entirely without merit. According to petitioners, *Shutts* stands for the proposition that class members are "free to sit it out" — *i.e.*, accept a state court settlement — and then at some indeterminate time thereafter launch a collateral attack. Pet. at 9-10. But as petitioners have previously conceded, *Shutts* says nothing about collateral attack. In *Shutts*, this Court held that the due process standard for asserting jurisdiction over absent class action plaintiffs is significantly lower than that for absent defendants because, among other reasons, plaintiffs are subjected to fewer burdens. 472 U.S. at 808-11. This Court explained that

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6. The lower court cases cited by petitioners are entirely inapposite. *See, e.g., In re "Agent Orange" Prod. Liability Litig.*, 996 F.2d 1425, 1428 (2d Cir. 1993) (rejecting on *direct appeal* a due process challenge to a settlement judgment even though parties seeking review did not know, at the time that the class action settlement was reached, they were members of the class); *In re Real Estate Title and Settlement Servs. Antitrust Litig.*, 869 F.2d 760, 765 (3d Cir. 1989) (holding on *direct appeal* that parties without minimum contacts with the forum are not bound by a *non-opt out* class action judgment); *Gonzales v. Cassidy*, 474 F.2d 67, 76 (5th Cir. 1973) (finding that a class representative's abandonment of an appeal once he obtained individual relief — even though other class members had not been granted relief — rendered the class representative inadequate in a *non-opt out* class action).

"[u]nlike a defendant in a normal civil suit, an absent class-action plaintiff is not required to do anything. He may sit back and allow the litigation to run its course, content in knowing that there are safeguards provided for his protection." *Id.* at 810. Petitioners wrest this sentence out of context to assert that absent class members may simply do "nothing," and having done nothing, subsequently attack in another forum the very safeguards referred to in *Shutts* — adequacy of representation and court scrutiny of the settlement. To the contrary, *Shutts* makes clear that class members who fail to opt out are bound by the outcome of the class action. *Id.* at 813 ("the Constitution does not require more to protect what must be the somewhat rare species of class member who is unwilling to execute an 'opt out' form, but whose claim is nonetheless so important that he cannot be presumed to consent to being a member of the class by his failure to do so").

Shutts indicates that where a state court has provided the minimum procedural safeguards for asserting jurisdiction over a class action and made a finding that the safeguards were followed, any judgment rendered in the class action is *res judicata* against all members of the class. *Id.* at 805. As noted by this Court in *Matsushita*, each of the procedural safeguards identified in *Shutts* was provided for by Delaware law and followed by the Court of Chancery. Resp't App. 12a-13a. Consequently, as this Court previously held, class members are bound by the judgment. *Id.* at 13a.[7]

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7. Petitioners' assertion that the Ninth Circuit's decision effectively forces absent class members to hire counsel and actively monitor every class action proceeding in which they have an interest (Pet. at 14-15) ignores the option available to these class members — the right to opt out. In fact, courts have held that where a party

(Cont'd)

3. *The Ninth Circuit's Decision Is Consistent With Decisions From Other Circuit Courts Of Appeal*

Petitioners erroneously suggest that the Ninth Circuit's decision creates a split among the Courts of Appeal. The Ninth Circuit's decision, in fact, accords with the decisions of every Court of Appeals that has addressed a collateral challenge to adequacy of representation in a state court class action. *See* Sup. Ct. R. 10(a); *Grimes*, 17 F.3d at 1558 (finding that a Delaware state court's determination that a *non*-opt-out class received adequate representation is binding on class members and refusing to allow class members "to relitigate the issue of whether they were adequately represented during the settlement negotiations"); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33 (1st Cir. 1991) (finding that parties to a Delaware state class action were precluded from collaterally attacking the Delaware court judgment); *cf. In re General Motors Corp. Pick-up Truck Fuel Tank Prods. Liability Litig.*, 134 F.3d 133, 142 (3d Cir. 1998) (refusing to enjoin class action settlement that is final and valid under Louisiana law). There is no Circuit Court conflict for this Court to address.

(Cont'd)
knows the terms of the settlement, and chooses not to opt out, the party cannot later attack the judgment. *See Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370 (9th Cir. 1993), *cert. denied*, 512 U.S. 1220 (1994) (class member who receives notice of the terms of a proposed settlement and chooses not to opt out of the class cannot subsequently attack the approved settlement on the ground of inadequate representation).

CONCLUSION

For all of the foregoing reasons, the petition should be denied.

Respectfully submitted,

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Supreme Court, U.S.
F I L E D
OCT 8 1999

No. 99-417

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

APPENDIX

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APPENDIX A — OPINION OF THE SUPREME COURT OF THE UNITED STATES DATED AND DECIDED FEBRUARY 27, 1996

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD., et al., Petitioners,

v.

Lawrence EPSTEIN et al.

No. 94-1809.

Supreme Court of the United States

Argued Nov. 27, 1995.

Decided Feb. 27, 1996.

* * *

Justice THOMAS delivered the opinion of the Court.

This case presents the question whether a federal court may withhold full faith and credit from a state-court judgment approving a class-action settlement simply because the settlement releases claims within the exclusive jurisdiction of the federal courts. The answer is no. Absent a partial repeal of the Full Faith and Credit Act, 28 U.S.C. § 1738, by another federal statute, a federal court must give the judgment the same effect that it would have in the courts of the State in which it was rendered.

I

In 1990, petitioner Matsushita Electric Industrial Co. made a tender offer for the common stock of MCA, Inc., a

Delaware corporation. The tender offer not only resulted in Matsushita's acquisition of MCA, but also precipitated two lawsuits on behalf of the holders of MCA's common stock. First, a class action was filed in the Delaware Court of Chancery against MCA and its directors for breach of fiduciary duty in failing to maximize shareholder value. The complaint was later amended to state additional claims against MCA's directors for, *inter alia*, waste of corporate assets by exposing MCA to liability under the federal securities laws. In addition, Matsushita was added as a defendant and was accused of conspiring with MCA's directors to violate Delaware law. The Delaware suit was based purely on state-law claims.

While the state class action was pending, the instant suit was filed in Federal District Court in California. The complaint named Matsushita as a defendant and alleged that Matsushita's tender offer violated Securities Exchange Commission (SEC) Rules 10b-13 and 14d-10.[1] These Rules were created by the SEC pursuant to the 1968 Williams Act Amendments to the Securities Exchange Act of 1934 (Exchange Act), 48 Stat. 881, as amended, 15 U.S.C. § 78a *et seq*. Section 27 of the Exchange Act confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promulgated thereunder. See 15 U.S.C. § 78aa. The District Court declined to certify the class, entered summary judgment for Matsushita, and dismissed the case. The plaintiffs appealed to the Court of Appeals for the Ninth Circuit.

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1. We express no opinion in this case on the existence of a private cause of action under §§ 14(d)(6) and (7) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78n(d)(6) and (7), the statutory authority for Rule 14d-10.

Appendix A

After the federal plaintiffs filed their notice of appeal but before the Ninth Circuit handed down a decision, the parties to the Delaware suit negotiated a settlement.[2] In exchange for a global release of all claims arising out of the Matsushita-MCA acquisition, the defendants would deposit $2 million into a settlement fund to be distributed pro rata to the members of the class. As required by Delaware Chancery Rule 23, which is modeled on Federal Rule of Civil Procedure 23, the Chancery Court certified the class for purposes of settlement and approved a notice of the proposed settlement. The notice informed the class members of their right to request exclusion from the settlement class and to appear and present argument at a scheduled hearing to determine the fairness of the settlement. In particular, the notice stated that "[b]y filing a valid Request for Exclusion, a member of the Settlement Class will not be precluded by the Settlement from individually seeking to pursue the claims alleged in the . . . California Federal Actions, . . . or any other claim relating to the events at issue in the Delaware Actions." App. to Pet. for Cert. 96a. Two such notices were mailed to the class members and the notice was also published in the national edition of the Wall Street Journal. The Chancery Court then held a hearing. After argument from several objectors, the Court found the class representation adequate and the settlement fair.

The order and final judgment of the Chancery Court incorporated the terms of the settlement agreement, providing:

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2. A previous settlement was rejected by the Court of Chancery as unfair to the class. See *In re MCA, Inc. Shareholders Litigation*, 598 A.2d 687 (1991).

Appendix A

> "All claims, rights and causes of action (state or federal, including but not limited to claims arising under the federal securities law, any rules or regulations promulgated thereunder, or otherwise), whether known or unknown that are, could have been or might in the future be asserted by any of the plaintiffs or any member of the Settlement Class (*other than those who have validly requested exclusion therefrom*), . . . in connection with or that arise now or hereafter out of the Merger Agreement, the Tender Offer, the Distribution Agreement, the Capital Contribution Agreement, the employee compensation arrangements, the Tender Agreements, the Initial Proposed Settlement, this Settlement . . . *and including without limitation the claims asserted in the California Federal Actions* . . . are hereby compromised, settled, released and discharged with prejudice by virtue of the proceedings herein and this Order and Final Judgment." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740 (Feb. 22, 1993), reprinted in App. to Pet. for Cert. 74a-75a (emphasis added).

The judgment also stated that the notice met all the requirements of due process. The Delaware Supreme Court affirmed. *In re MCA, Inc., Shareholders Litigation*, 633 A.2d 370 (1993) (judgt. order).

Respondents were members of both the state and federal plaintiff classes. Following issuance of the notice of proposed settlement of the Delaware litigation, respondents neither

opted out of the settlement class nor appeared at the hearing to contest the settlement or the representation of the class. On appeal in the Ninth Circuit, petitioner Matsushita invoked the Delaware judgment as a bar to further prosecution of that action under the Full Faith and Credit Act, 28 U.S.C. § 1738.

The Ninth Circuit rejected petitioner's argument, ruling that § 1738 did not apply. *Epstein v. MCA, Inc.*, 50 F.3d 644, 661-666 (1995). Instead, the Court of Appeals fashioned a test under which the preclusive force of a state-court settlement judgment is limited to those claims that "could . . . have been extinguished by the issue preclusive effect of an adjudication of the state claims." *Id.*, at 665. The lower courts have taken varying approaches to determining the preclusive effect of a state-court judgment, entered in a class or derivative action, that provides for the release of exclusively federal claims.[3] We granted certiorari to clarify this important area of federal law. 515 U.S. 1187 (1995).

II

The Full Faith and Credit Act mandates that the "judicial proceedings" of any State "shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." 28 U.S.C. § 1738. The Act thus directs

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3. Compare the decision below with *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (CA3), cert. denied, 513 U.S. 986 (1994); *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (CA1 1991); and *Abramson v. Pennwood Investment Corp.*, 392 F.2d 759 (CA2 1968).

all courts to treat a state-court judgment with the same respect that it would receive in the courts of the rendering State. Federal courts may not "employ their own rules . . . in determining the effect of state judgments," but must "accept the rules chosen by the State from which the judgment is taken." *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-482 (1982). Because the Court of Appeals failed to follow the dictates of the Act, we reverse.

A

The state court judgment in this case differs in two respects from the judgments that we have previously considered in our cases under the Full Faith and Credit Act. As respondents and the Court of Appeals stressed, the judgment was the product of a class action and incorporated a settlement agreement releasing claims within the exclusive jurisdiction of the federal courts. Though respondents urge "the irrelevance of section 1738 to this litigation," Brief for Respondents 25, we do not think that either of these features exempts the judgment from the operation of § 1738.

That the judgment at issue is the result of a class action, rather than a suit brought by an individual, does not undermine the initial applicability of § 1738. The judgment of a state court in a class action is plainly the product of a "judicial proceeding" within the meaning of § 1738. Cf. *McDonald v. West Branch*, 466 U.S. 284, 287-288 (1984) (holding that § 1738 does not apply to arbitration awards because arbitration is not a "judicial proceeding"). Therefore, a judgment entered in a class action, like any other judgment entered in a state judicial proceeding, is presumptively

entitled to full faith and credit under the express terms of the Act.

Further, § 1738 is not irrelevant simply because the judgment in question might work to bar the litigation of exclusively federal claims. Our decision in *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373 (1985), made clear that where § 1738 is raised as a defense in a subsequent suit, the fact that an allegedly precluded "claim is within the exclusive jurisdiction of the federal courts *does not necessarily make § 1738 inapplicable.*" *Id.*, at 380 (emphasis added). In so holding, we relied primarily on *Kremer v. Chemical Constr. Corp.*, *supra*, which held, without deciding whether claims under Title VII are exclusively federal, that state court proceedings may be issue preclusive in Title VII suits in federal court. *Kremer*, we said, "implies that absent an exception to § 1738, state law determines at least the . . . preclusive effect of a prior state judgment in a subsequent action involving a claim within the exclusive jurisdiction of the federal courts." *Marrese*, 470 U.S., at 381. Accordingly, we decided that "a state court judgment may in some circumstances have preclusive effect in a subsequent action within the exclusive jurisdiction of the federal courts." *Id.*, at 380.

In *Marrese*, we discussed *Nash County Bd. of Ed. v. Biltmore Co.*, 640 F.2d 484 (CA4), cert. denied, 454 U.S. 878 (1981), a case that concerned a state court settlement judgment. In *Nash*, the question was whether the judgment, which approved the settlement of state antitrust claims, prevented the litigation of exclusively federal antitrust claims. See 470 U.S., at 382, n. 2. We suggested that the

approach outlined in *Marrese* would also apply in cases like *Nash* that involve judgments upon settlement: that is, § 1738 would control at the outset. See 470 U.S., at 382, n. 2. In accord with these precedents, we conclude that § 1738 is generally applicable in cases in which the state-court judgment at issue incorporates a class-action settlement releasing claims solely within the jurisdiction of the federal courts.

B

Marrese provides the analytical framework for deciding whether the Delaware court's judgment precludes this exclusively federal action. When faced with a state-court judgment relating to an exclusively federal claim, a federal court must first look to the law of the rendering State to ascertain the effect of the judgment. See *id.*, at 381-382. If state law indicates that the particular claim or issue would be barred from litigation in a court of that State, then the federal court must next decide whether, "as an exception to § 1738," it "should refuse to give preclusive effect to [the] state court judgment." *Id.*, at 383. See also *Migra v. Warren City School Dist. Bd. of Ed.*, 465 U.S. 75, 81 (1984) ("[I]n the absence of federal law modifying the operation of § 1738, the preclusive effect in federal court of [a] state-court judgment is determined by [state] law").

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We observed in *Marrese* that the inquiry into state law would not always yield a direct answer. Usually, "a state court will not have occasion to address the specific question

whether a state judgment has issue or claim preclusive effect in a later action that can be brought only in federal court." 470 U.S., at 381-382. Where a judicially approved settlement is under consideration, a federal court may consequently find guidance from general state law on the preclusive force of settlement judgments. See, *e.g.*, *id.*, at 382-383, n. 2 (observing in connection with *Nash* that "[North Carolina] law gives preclusive effect to consent judgment[s]"). Here, in addition to providing rules regarding the preclusive force of class-action settlement judgments in subsequent suits in state court, the Delaware courts have also spoken to the particular effect of such judgments in federal court.

Delaware has traditionally treated the impact of settlement judgments on subsequent litigation in state court as a question of claim preclusion. Early cases suggested that Delaware courts would not afford claim preclusive effect to a settlement releasing claims that could not have been presented in the trial court. See *Ezzes v. Ackerman*, 234 A.2d 444, 445-446 (Del.1967) ("[A] judgment entered either after trial on the merits or upon an approved settlement is *res judicata* and bars subsequent suit on the same claim. . . . [T]he defense of *res judicata* . . . is available if the pleadings framing the issues in the first action would have permitted the raising of the issue sought to be raised in the second action, and if the facts were known, or could have been known to the plaintiff in the second action at the time of the first action"). As the Court of Chancery has perceived, however, "the *Ezzes* inquiry [was] modified in regard to class actions," *In re Union Square Associates Securities Litigation*, C.A. No. 11028, 1993 WL 220528, *3 (June 16, 1993), by the Delaware Supreme Court's decision in *Nottingham Partners v. Dana*, 564 A.2d 1089 (1989).

Appendix A

In *Nottingham*, a class action, the Delaware Supreme Court approved a settlement that released claims then pending in federal court. In approving that settlement, the *Nottingham* Court appears to have eliminated the *Ezzes* requirement that the claims could have been raised in the suit that produced the settlement, at least with respect to class actions:

> " '[I]n order to achieve a comprehensive settlement that would prevent relitigation of settled questions at the core of a class action, a court may permit the release of a claim based on the identical factual predicate as that underlying the claims in the settled class action even though the claim was not presented and might not have been presentable in the class action.' " 564 A.2d, at 1106 (quoting *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 460 (CA2 1982)).

See *Union Square*, *supra*, at *3 (relying directly on *Nottingham* to hold that a Delaware court judgment settling a class action was res judicata and barred arbitration of duplicative claims that could not have been brought in the first suit). These cases indicate that even if, as here, a claim could not have been raised in the court that rendered the settlement judgment in a class action, a Delaware court would still find that the judgment bars subsequent pursuit of the claim.

The Delaware Supreme Court has further manifested its understanding that when the Court of Chancery approves a global release of claims, its settlement judgment should

preclude ongoing or future federal-court litigation of any released claims. In *Nottingham*, the Court stated that "[t]he validity of executing a general release in conjunction with the termination of litigation has long been recognized by the Delaware courts. More specifically, the Court of Chancery has a history of approving settlements that have implicitly or explicitly included a general release, which would also release federal claims." 564 A.2d, at 1105 (citation omitted). Though the Delaware Supreme Court correctly recognized in *Nottingham* that it lacked actual authority to order the dismissal of any case pending in federal court, it asserted that state-court approval of the settlement would have the collateral effect of preventing class members from prosecuting their claims in federal court. Perhaps the clearest statement of the Delaware Chancery Court's view on this matter was articulated in the suit preceding this one: "When a state court settlement of a class action releases all claims which arise out of the challenged transaction and is determined to be fair and to have met all due process requirements, the class members are bound by the release or the doctrine of issue preclusion. Class members cannot subsequently relitigate the claims barred by the settlement in a federal court." *In re MCA, Inc. Shareholders Litigation*, 598 A.2d 687, 691 (1991).[4] We are aware of no Delaware case that suggests otherwise.

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4. In fact, the Chancery Court rejected the first settlement, which contained no opt-out provision, as unfair to the class precisely because it believed that the settlement would preclude the class from pursuing their exclusively federal claims in federal court. See *In re MCA Inc. Shareholders Litigation*, 598 A.2d, at 692 ("[I]f this Court provides for the release of all the claims arising out of the challenged transaction, the claims which the Objectors have asserted in the federal suit will likely be forever barred").

Given these statements of Delaware law, we think that a Delaware court would afford preclusive effect to the settlement judgment in this case, notwithstanding the fact that respondents could not have pressed their Exchange Act claims in the Court of Chancery. The claims are clearly within the scope of the release in the judgment, since the judgment specifically refers to this lawsuit. As required by Delaware Court of Chancery Rule 23, see *Prezant v. De Angelis*, 636 A.2d 915, 920 (1994), the Court of Chancery found, and the Delaware Supreme Court affirmed, that the settlement was "fair, reasonable and adequate and in the best interests of the . . . Settlement class" and that notice to the class was "in full compliance with . . . the requirements of due process." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740 (Feb. 22, 1993), reprinted in App. to Pet. for Cert. 73a, 74a. Cf. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985) (due process for class action plaintiffs requires "notice plus an opportunity to be heard and participate in the litigation"). The Court of Chancery "further determined that the plaintiffs[,] . . . as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class." *In re MCA, Inc. Shareholders Litigation*, *supra*, reprinted in App. to Pet. for Cert. 73a. Cf. *Phillips Petroleum Co.*, *supra*, at 812 (due process requires "that the named plaintiff at all times adequately represent the interests of the absent class members").[5] Under Delaware

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5. Apart from any discussion of Delaware law, respondents contend that the settlement proceedings did not satisfy due process because the class was inadequately represented. See Brief for Respondents 34-45. Respondents make this claim in spite of the Chancery Court's express ruling, following argument on the issue, (Cont'd)

Rule 23, as under Federal Rule of Civil Procedure 23, "[a]ll members of the class, whether of a plaintiff or a defendant class, are bound by the judgment entered in the action unless, in a Rule 23(b)(3) action, they make a timely election for exclusion." 2 H. Newberg, Class Actions § 2755, p. 1224 (1977). See also *Cooper v. Federal Reserve Bank of Richmond*, 467 U.S. 867, 874 (1984) ("There is of course no dispute that under elementary principles of prior adjudication a judgment in a properly entertained class action is binding on class members in any subsequent litigation"). Respondents do not deny that, as shareholders of MCA's common stock, they were part of the plaintiff class and that they never opted out; they are bound, then, by the judgment.[6]

(Cont'd)

that the class representatives fairly and adequately protected the interests of the class. Cf. *Prezant v. De Angelis*, 636 A.2d 915, 923 (Del.1994) ("[The] constitutional requirement [of adequacy of representation] is embodied in [Delaware] Rule 23(a)(4), which requires that the named plaintiff 'fairly and adequately protect the interests of the class' "). We need not address the due process claim, however, because it is outside the scope of the question presented in this Court. See *Yee v. Escondido*, 503 U.S. 519, 533 (1992). While it is true that a respondent may defend a judgment on alternative grounds, we generally do not address arguments that were not the basis for the decision below. See *Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80, 86 (1988).

6. Respondents argue that their failure to opt out of the settlement class does not constitute consent to the terms of the settlement under traditional contract principles. Brief for Respondents 16-25. Again, the issue raised by respondents — whether the settlement could bar this suit as a matter of contract

(Cont'd)

Because it appears that the settlement judgment would be res judicata under Delaware law, we proceed to the second step of the *Marrese* analysis and ask whether § 27 of the Exchange Act, which confers exclusive jurisdiction upon the federal courts for suits arising under the Act, partially repealed § 1738. Section 27 contains no express language regarding its relationship with § 1738 or the preclusive effect of related state-court proceedings. Thus, any modification of § 1738 by § 27 must be implied. In deciding whether § 27 impliedly created an exception to § 1738, the "general question is whether the concerns underlying a particular grant of exclusive jurisdiction justify a finding of an implied partial repeal of § 1738." *Marrese*, 470 U.S., at 386. "Resolution of this question will depend on the particular federal statute as well as the nature of the claim or issue involved in the subsequent federal action. . . . [T]he primary consideration must be the intent of Congress." *Ibid.*

As an historical matter, we have seldom, if ever, held that a federal statute impliedly repealed § 1738. See *Parsons Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 523-525 (1986) (Anti-Injunction Act does not limit § 1738); *Migra*

(Cont'd)

law, as distinguished from § 1738 law — is outside the scope of the question on which we granted certiorari. We note, however, that if a State chooses to approach the preclusive effect of a judgment embodying the terms of a settlement agreement as a question of pure contract law, a federal court must adhere to that approach under § 1738. *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481-482 (1982).

v. Warren City School Dist. Bd. of Ed., 465 U.S., at 83-85 (§ 1983 does not limit claim preclusion under § 1738); *Kremer v. Chemical Constr. Corp.*, 456 U.S., at 468-476 (Title VII of the Civil Rights Act of 1964 does not limit § 1738); *Allen v. McCurry*, 449 U.S. 90, 96-105 (1980) (§ 1983 does not limit issue preclusion under § 1738). But cf. *Brown v. Felsen*, 442 U.S. 127, 138-139 (1979) (declining to give claim preclusive effect to prior state-court debt collection proceeding in federal bankruptcy suit, without discussing § 1738, state law, or implied repeals). The rarity with which we have discovered implied repeals is due to the relatively stringent standard for such findings, namely, that there be an " 'irreconcilable conflict' " between the two federal statutes at issue. *Kremer v. Chemical Constr. Corp.*, *supra*, at 468 (quoting *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 154 (1976)).

Section 27 provides that "[t]he district courts of the United States . . . shall have exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa. There is no suggestion in § 27 that Congress meant for plaintiffs with Exchange Act claims to have more than one day in court to challenge the legality of a securities transaction. Though the statute plainly mandates that suits alleging violations of the Exchange Act may be maintained only in federal court, nothing in the language of § 27 "remotely expresses any congressional intent to contravene the common-law rules of preclusion or to repeal the express statutory requirements of . . . 28 U.S.C. § 1738." *Allen v. McCurry*, *supra*, at 97-98.

Nor does § 27 evince any intent to prevent litigants in state court — whether suing as individuals or as part of a class — from voluntarily releasing Exchange Act claims in judicially approved settlements. While § 27 prohibits state courts from adjudicating claims arising under the Exchange Act, it does not prohibit state courts from approving the release of Exchange Act claims in the settlement of suits over which they have properly exercised jurisdiction, *i.e.*, suits arising under state law or under federal law for which there is concurrent jurisdiction. In this case, for example, the Delaware action was not "brought to enforce" any rights or obligations under the Act. The Delaware court asserted judicial power over a complaint asserting purely state-law causes of action[7] and, after the parties agreed to settle, certified the class and approved the settlement pursuant to the requirements of Delaware Rule of Chancery 23 and the Due Process Clause. Thus, the Delaware court never trespassed upon the exclusive territory of the federal courts, but merely approved the settlement of a common-law suit pursuant to state and nonexclusive federal law. See *Abramson v. Pennwood Investment Corp.*, 392 F.2d 759, 762 (CA2 1968) ("Although the state court could not adjudicate the federal claim, it was within its powers over the corporation and the parties to approve the release of that claim as a condition of settlement of the state action"). While it is true that the state court assessed the general worth of the federal claims in determining the fairness of the settlement, such

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7. Though the plaintiff class premised one of its claims of fiduciary breach on the allegation that MCA wasted corporate assets by exposing the corporation to liability under the federal securities laws, the cause pleaded was nonetheless a state common-law action for breach of fiduciary duty.

assessment does not amount to a judgment on the merits of the claims. See *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 461 (CA2 1982) (" 'Approval of a settlement does not call for findings of fact regarding the claims to be compromised. The court is concerned only with the *likelihood* of success or failure; the actual merits of the controversy are not to be determined' ") (quoting Haudek, The Settlement and Dismissal of Stockholders' Actions-Part II: The Settlement, 23 Sw.L.J. 765, 809 (1969) (footnotes omitted)). The Delaware court never purported to resolve the merits of the Exchange Act claims in the course of appraising the settlement; indeed, it expressly disavowed that purpose. See *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740 (Feb. 16, 1993), reprinted in App. to Pet. for Cert. 68a ("In determining whether a settlement should be approved, a court should not try the merits of the underlying claims. This principle would seem to be especially appropriate where the underlying claims, like the federal claims here, are outside the jurisdiction of this Court" (citation omitted)).

The legislative history of the Exchange Act elucidates no specific purpose on the part of Congress in enacting § 27. See *Murphy v. Gallagher*, 761 F.2d 878, 885 (CA2 1985) (noting that the legislative history of the Exchange Act provides no readily apparent explanation for the provision of exclusive jurisdiction in § 27) (citing 2 & 3 L. Loss, Securities Regulation 997, 2005 (2d ed.1961)). We may presume, however, that Congress intended § 27 to serve at least the general purposes underlying most grants of exclusive jurisdiction: "to achieve greater uniformity of construction and more effective and expert application of that law." *Murphy v. Gallagher*, *supra*, at 885. When a state

court upholds a settlement that releases claims under the Exchange Act, it threatens neither of these policies. There is no danger that state-court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder. And the uniform construction of the Act is unaffected by a state court's approval of a proposed settlement because the state court does not adjudicate the Exchange Act claims but only evaluates the overall fairness of the settlement, generally by applying its own business judgment to the facts of the case. See, *e.g.*, *Polk v. Good*, 507 A.2d 531, 535 (Del.1986).

Furthermore, other provisions of the Exchange Act suggest that Congress did not intend to create an exception to § 1738 for suits alleging violations of the Act. Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions. See 15 U.S.C. § 78bb(a) (preserving "all other rights and remedies that may exist at law or in equity"). And all that Congress chose to say about the consequences of such litigation is that plaintiffs ought not obtain double recovery. See *ibid.* Congress said nothing to modify the background rule that where a state-court judgment precedes that of a federal court, the federal court must give full faith and credit to the state-court judgment. See *Murphy v. Gallagher*, *supra*, at 884.

Finally, precedent supports the conclusion that the concerns underlying the grant of exclusive jurisdiction in § 27 are not undermined by state-court approval of settlements releasing Exchange Act claims. We have held that state court proceedings may, in various ways, subsequently affect the litigation of exclusively federal claims without running afoul of the federal jurisdictional

grant in question. In *Becher v. Contoure Laboratories, Inc.*, 279 U.S. 388 (1929) (cited in *Marrese*, 470 U.S., at 381), we held that state court findings of fact were issue preclusive in federal patent suits. We did so with full recognition that "the logical conclusion from the establishing of [the state law] claim is that Becher's patent is void." 279 U.S., at 391. Becher reasoned that although "decrees validating or invalidating patents belong to the Courts of the United States," that "does not give sacrosanctity to facts that may be conclusive upon the question in issue." *Ibid.* Similarly, while binding legal determinations of rights and liabilities under the Exchange Act are for federal courts only, there is nothing sacred about the approval of settlements of suits arising under state law, even where the parties agree to release exclusively federal claims. See also *Brown v. Felsen*, 442 U.S., at 139, n. 10 (noting that "[i]f, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17, then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court"); *Pratt v. Paris Gaslight & Coke Co.*, 168 U.S. 255, 258 (1897) (when a state court has jurisdiction of the parties and the subject matter of the complaint, the state court may decide the validity of a patent when that issue is raised as a defense).

We have also held that Exchange Act claims may be resolved by arbitration rather than litigation in federal court. In *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987), we found that parties to an arbitration agreement could waive the right to have their Exchange Act claims tried in federal court and agree to arbitrate the claims. *Id.*, at 227-228. It follows that state-court litigants ought also to be able

to waive, or "release," the right to litigate Exchange Act claims in a federal forum as part of a settlement agreement. As *Shearson/American Express Inc.* demonstrates, a statute conferring exclusive federal jurisdiction for a certain class of claims does not necessarily require resolution of those claims in a federal court.

Taken together, these cases stand for the general proposition that even when exclusively federal claims are at stake, there is no "universal right to litigate a federal claim in a federal district court." *Allen v. McCurry*, 449 U.S., at 105. If class action plaintiffs wish to preserve absolutely their right to litigate exclusively federal claims in federal court, they should either opt out of the settlement class or object to the release of any exclusively federal claims. In fact, some of the plaintiffs in the Delaware class action requested exclusion from the settlement class. They are now proceeding in federal court with their federal claims, unimpeded by the Delaware judgment.

In the end, §§ 27 and 1738 "do not pose an either-or proposition." *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 253 (1992). They can be reconciled by reading § 1738 to mandate full faith and credit of state-court judgments incorporating global settlements, provided the rendering court had jurisdiction over the underlying suit itself, and by reading § 27 to prohibit state courts from exercising jurisdiction over suits arising under the Exchange Act. Cf. 18 C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 4470, pp. 688-689 (1981) ("[S]ettlement of state court litigation has been held to defeat a subsequent federal action if the settlement was intended to apply to claims in exclusive federal jurisdiction as well as other claims. . . .

These rulings are surely correct"). Congress' intent to provide an exclusive federal forum for adjudication of suits to enforce the Exchange Act is clear enough. But we can find no suggestion in § 27 that Congress meant to override the "principles of comity and repose embodied in § 1738," *Kremer v. Chemical Constr. Corp.*, 456 U.S., at 463, by allowing plaintiffs with Exchange Act claims to release those claims in state court and then litigate them in federal court. We conclude that the Delaware courts would give the settlement judgment preclusive effect in a subsequent proceeding and, further, that § 27 did not effect a partial repeal of § 1738.

C

The Court of Appeals did not engage in any analysis of Delaware law pursuant to § 1738. Rather, the Court of Appeals declined to apply § 1738 on the ground that where the rendering forum lacked jurisdiction over the subject matter or the parties, full faith and credit is not required. 50 F.3d, at 661, 666. See *Underwriters Nat. Assurance Co. v. North Carolina Life & Accident & Health Ins. Guaranty Assn.*, 455 U.S. 691, 704-705 (1982) (" '[A] judgment of a court in one State is conclusive upon the merits in a court in another State only if the court in the first State had power to pass on the merits — had jurisdiction, that is, to render the judgment' ") (quoting *Durfee v. Duke*, 375 U.S. 106, 110 (1963)). The Court of Appeals decided that the subject-matter jurisdiction exception to full faith and credit applies to this case because the Delaware court acted outside the bounds of its own jurisdiction in approving the settlement, since the settlement released exclusively federal claims. See 50 F.3d, at 661-662, and n. 25.

As explained above, the state court in this case clearly possessed jurisdiction over the subject matter of the underlying suit and over the defendants. Only if this were not so — for instance, if the complaint alleged violations of the Exchange Act and the Delaware court rendered a judgment on the merits of those claims — would the exception to § 1738 for lack of subject-matter jurisdiction apply. Where, as here, the rendering court in fact had subject-matter jurisdiction, the subject-matter jurisdiction exception to full faith and credit is simply inapposite. In such a case, the relevance of a federal statute that provides for exclusive federal jurisdiction is not to the state court's possession of jurisdiction *per se*, but to the existence of a partial repeal of § 1738.[8]

* * *

The judgment of the Court of Appeals is reversed, and remanded for proceedings consistent with this opinion.

It is so ordered.

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8. *Kalb v. Feuerstein*, 308 U.S. 433 (1940), is not to the contrary. In that case, the federal statute at issue expressly prohibited certain common-law actions from being either instituted or maintained in state court. *Id.*, at 440-441. Thus, by merely entertaining a common-law foreclosure suit, over which it otherwise would have had jurisdiction, the state court violated the terms of the Act. That is not the situation here, where there is no contention that just by entertaining the class action the Delaware court acted in violation of federal law.

Appendix A

Justice STEVENS, concurring in part and dissenting in part.

While I join Parts I, II-A, and II-C of the Court's opinion, and while I also agree with the Court's reasons for concluding that § 27 of the Securities Exchange Act of 1934 does not create an implied partial repeal of the Full Faith and Credit Act, I join neither Part II-B nor the Court's judgment because I agree with Justice GINSBURG that the question of Delaware law should be addressed by the Court of Appeals in the first instance, and that the Ninth Circuit remains free to consider whether Delaware courts fully and fairly litigated the adequacy of class representation.

Justice GINSBURG, with whom Justice STEVENS joins, and with whom Justice SOUTER joins as to Part II-B, concurring in part and dissenting in part.

I join the Court's judgment to the extent that it remands the case to the Ninth Circuit. I agree that a remand is in order because the Court of Appeals did not attend to this Court's reading of 28 U.S.C. § 1738 in a controlling decision, *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461 (1982). But I would not endeavor, as the Court does, to speak the first word on the content of Delaware preclusion law. Instead, I would follow our standard practice of remitting that issue for decision, in the first instance, by the lower federal courts. See, *e.g.*, *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 387 (1985).

I write separately to emphasize a point key to the application of § 1738: A state-court judgment generally is

not entitled to full faith and credit unless it satisfies the requirements of the Fourteenth Amendment's Due Process Clause. See *Kremer*, 456 U.S., at 482-483. In the class-action setting, adequate representation is among the due process ingredients that must be supplied if the judgment is to bind absent class members. See *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 808, 812 (1985); *Prezant v. De Angelis*, 636 A.2d 915, 923-924 (Del. 1994).

Suitors in this action (called the "Epstein plaintiffs" in this opinion), respondents here, argued before the Ninth Circuit, and again before this Court, that they cannot be bound by the Delaware settlement because they were not adequately represented by the Delaware class representatives. They contend that the Delaware representatives' willingness to release federal securities claims within the exclusive jurisdiction of the federal courts for a meager return to the class members, but a solid fee to the Delaware class attorneys, disserved the interests of the class, particularly, the absentees. The inadequacy of representation was apparent, the Epstein plaintiffs maintained, for at the time of the settlement, the federal claims were *sub judice* in the proper forum for those claims — the federal judiciary. Although the Ninth Circuit decided the case without reaching the due process check on the full faith and credit obligation, that inquiry remains open for consideration on remand. See *ante*, at 379, n. 5 (due process "w[as] not the basis for the decision below," so the Court "need not address [it]").

I

Matsushita's acquisition of MCA prompted litigation in state and federal courts. A brief account of that litigation

will facilitate comprehension of the Epstein plaintiffs' position. On September 26, 1990, in response to reports in the financial press that Matsushita was negotiating to buy MCA, a suit was filed in the Court of Chancery of Delaware, a purported class action on behalf of the stockholders of MCA. Naming MCA and its directors (but not Matsushita) as defendants, the complaint invoked state law only. It alleged that MCA's directors had failed to carry out a market check to maximize shareholder value upon a change in corporate control, a check required by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del.1986). For this alleged breach of fiduciary duty, the complaint sought, *inter alia*, an injunction against Matsushita's proposed acquisition of MCA.

Matsushita announced its tender offer on November 26, 1990. It offered holders of MCA common stock $71 per share, if they tendered their shares before December 29, 1990. The owners of 91% of MCA's common stock tendered their shares and, on January 3, 1991, for a price of $6.1 billion, Matsushita acquired MCA.

On December 3, 1990, a few days after the required Securities and Exchange Commission (SEC) filings disclosed the terms of the tender offer, several MCA shareholders filed suit in the United States District Court for the Central District of California.[1] Based solely on federal law, their complaints

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1. Two sets of plaintiffs filed complaints in the Central District of California: the Epstein plaintiffs (including Lawrence Epstein, John Linder, Jane Rockford, Maurice Karlin, Ruth Karlin, Beth Karlin, and Bert Karlin) sued both individually and on behalf of all

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alleged that Matsushita, first named defendant, violated SEC Rules 14d-10, 17 CFR § 240.14d-10 (1994), and 10b-13, *id.*, § 240.10b-13, by offering preferential treatment in the tender offer to MCA principals Lew Wasserman and Sidney Sheinberg. As stated in the complaint, the public tender offer included a special tax-driven stock swap arrangement for Wasserman, then MCA's chairman and chief executive officer, and a $21 million bonus for Sheinberg, then MCA's chief operating officer and owner of 1,170,000 shares of MCA common stock. These arrangements allegedly violated, *inter alia*, the SEC's "all-holder best-price" rule (Rule 14d-10), which requires bidders to treat all shareholders on equal terms. The claims of federal securities law violations fell within the exclusive jurisdiction of the federal court. See 15 U.S.C. § 78aa. The Epstein plaintiffs also sought class certification to represent all MCA shareholders at the time of the tender offer.

Two days later, counsel in the Delaware action advised MCA's counsel that the Delaware plaintiffs intended to amend their complaint to include additional claims against MCA and its directors and to add Matsushita as a defendant. The additional claims alleged that MCA wasted corporate

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MCA shareholders at the time of the tender offer; Walter Minton brought suit in his individual capacity. All had tendered their shares for the $71 tender price. The District Court consolidated the two cases. Minton and, it appears, Rockford opted out of the Delaware class-action settlement. Matsushita does not contest the qualification of Minton and Rockford, as individuals, to pursue federal claims unimpeded by the settlement in Delaware. See Brief for Petitioners ii. Matsushita does contest any class-action initiative in federal court.

assets by increasing the corporation's exposure to liability for violation of Rules 10b-13 and 14d-10, that MCA failed to make full disclosure of the benefits MCA insiders would receive from the takeover, and that directors Wasserman and Sheinberg breached their fiduciary duties by negotiating preferential deals with Matsushita. Matsushita, the amended complaint alleged, had conspired with and aided and abetted MCA directors in violation of Delaware law.

Within days, the Delaware parties agreed to a settlement and, on December 17, 1990, submitted their proposal to the Delaware Vice Chancellor. The agreement provided for a modification of a "poison pill" in the corporate charter of an MCA subsidiary,[2] and for a fees payment of $1 million to the class counsel. The settlement agreement required the release of all claims, state and federal, arising out of the tender offer.

The Vice Chancellor rejected the settlement agreement on April 22, 1991, for two reasons: the absence of any monetary benefit to the class members; and the potential value of the federal claims that the agreement proposed to release. The "generous payment" of $1 million in counsel fees, the Vice Chancellor observed, "confer[red] no benefit on the members of the Class." *In re MCA, Inc. Shareholders Litigation*, 598 A.2d 687, 695 (Del. Ch.1991). And the value of the revised poison pill to the class, the Vice Chancellor said, was "illusionary[,] . . . apparently . . . proposed merely

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2. The subsidiary in question was spun off from MCA during the merger because it owned a television station that federal law prohibited Matsushita from acquiring. The $71 tender offer price included $5 worth of stock in this new corporation.

to justify a settlement which offers no real monetary benefit to the Class." *Id.*, at 696. The Vice Chancellor described the state-law claims as "at best, extremely weak and, therefore, [of] little or no value." *Id.*, at 694. "[T]he only claims which have any substantial merit," he said, "are the claims . . . in the California federal suit that were not asserted in this Delaware action." *Id.*, at 696. After the rejection of the settlement, the Delaware lawsuit lay dormant for more than a year.

The federal litigation proceeded. In various rulings, the District Court denied the federal plaintiffs' motion for partial summary judgment, denied the Epstein plaintiffs' motion for class certification, and granted Matsushita's motion for summary judgment dismissing the claims. On April 15, 1992, the District Court entered its final judgment, which the Epstein plaintiffs appealed to the Ninth Circuit.

On October 22, 1992, after the federal plaintiffs had filed their notice of appeal, the Delaware parties reached a second settlement agreement. Matsushita agreed to create a $2 million settlement fund that would afford shareholders 2 to 3 cents per share before payment of fees and costs. The Delaware class counsel requested $691,000 in fees. In return for this relief, the Delaware plaintiffs agreed to release "all claims, rights and causes of action (state or federal, including but not limited to claims arising under the federal securities laws, and any rules or regulations promulgated thereunder, or otherwise) . . . in connection with or that arise now or hereafter out of the [tender offer] . . . including without limitation the claims asserted in the California Federal Actions. . . ." App. 187-188. Unlike the first settlement

proposal, the second agreement included an opt-out provision.

This time the Vice Chancellor approved the settlement. He stated: "[i]t is in the best interests of the class to settle this litigation and the terms of the settlement are fair and reasonable — although the value of the benefit to the class is meager." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 11740, 1993 WL 43024, *1 (Del. Ch., Feb.16, 1993). He found the class members' recovery of 2 to 3 cents per share "adequate (if only barely so) to support the proposed settlement." *Id.*, at *4. The federal claims, he reasoned, having been dismissed by the District Court, "now have minimal economic value." *Ibid.* And he gave weight to the presence in the second settlement agreement of an opt-out provision. *Ibid.*

Addressing the objectors' contention that the proposed settlement was "collusive," the Vice Chancellor recalled that "the settling parties ha[d] previously proposed a patently inadequate settlement," and he agreed that "suspicions abound." *Id.*, at *5. Nevertheless, he noted, the "[o]bjectors have offered no evidence of any collusion," so he declined to reject the settlement on that ground. *Ibid.* Reducing the counsel fees from the requested $691,000 to $250,000, the Vice Chancellor offered this observation: "[T]he defendants' willingness to create the settlement fund seems likely to have been motivated as much by their concern as to their potential liability under the federal claims as by their concern for liability under the state law claims which this Court characterized as 'extremely weak.' " *Id.*, at *6. In a brief order, the Delaware Supreme Court affirmed "on the basis

of and for the reasons assigned by the Court of Chancery. . . ." *In re MCA, Inc. Shareholders Litigation*, C.A. No. 126,1993, 1993 WL 385041, *1 (Sept. 21, 1993), judgt. order reported at 633 A.2d 370.

Before the Ninth Circuit, Matsushita argued that the Delaware class-action settlement barred litigation of the federal claims raised in the Epstein action. The Ninth Circuit disagreed. Relying on federal circuit court decisions,[3] the Court of Appeals held that state courts lack plenary power to approve settlements that effectively extinguish exclusively federal claims. Only if federal and state claims rest on the "identical factual predicate," the Ninth Circuit concluded, could a state-court settlement subsume an exclusively federal claim. It was not enough, in the Ninth Circuit's view, that the discrete federal and state claims stem from the "same transaction," the test Matsushita urged. 50 F.3d, at 661-665. The federal securities claims did not turn on the same operative facts as the state claims pleaded in Delaware, the Ninth Circuit found; accordingly, the federal claims could not have been extinguished by the issue-preclusive effect of an adjudication of the state claims. This analysis led the Ninth Circuit to declare that the Delaware decree "exceed[ed] the jurisdiction of the state court and, therefore, is not entitled to full faith and credit." *Id.*, at 666.

On the merits, the Ninth Circuit held, first, that a private right of action could be maintained to redress Rule 14d-10

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3. Closest in point, the court said, were *Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (CA3 1994), and *Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (CA1 1991). See *Epstein v. MCA, Inc.*, 50 F.3d 644, 662 (CA9 1995).

violations. *Id.*, at 652. The court next held that Matsushita violated Rule 14d-10 by paying Wasserman consideration not offered to other shareholders, *id.*, at 657; reversing the District Court's disposition of this matter, the Ninth Circuit held that plaintiffs were entitled to summary judgment on liability and remanded for a determination of damages, *ibid.* Regarding plaintiffs' claim that the $21 million payment to Sheinberg violated Rule 14d-10, the Ninth Circuit vacated the summary judgment for Matsushita and remanded for a determination whether the payment was in fact made to encourage Sheinberg to tender his shares. *Id.*, at 659.

II

A

Section 1738's full faith and credit instruction, as the Court indicates, requires the forum asked to recognize a judgment first to determine the preclusive effect the judgment would have in the rendering court. See *Kremer*, 456 U.S., at 466; *Marrese*, 470 U.S., at 381. Because the Ninth Circuit did not evaluate the preclusive effect of the Delaware judgment through the lens of that State's preclusion law, I would remand for that determination. See *id.*, at 386-387; *Migra v. Warren City School Dist. Bd. of Ed.*, 465 U.S. 75, 87 (1984) ("Prudence . . . dictates that it is the District Court, in the first instance, not this Court, that should interpret Ohio preclusion law and apply it.").[4]

4. In its endeavor to forecast Delaware preclusion law, the Court appears to have blended the "identical factual predicate" test applied by the Delaware Supreme Court in *Nottingham Partners v. Dana*, 564 A.2d 1089, 1106-1107 (1989), with the broader "same transaction" test advanced by Matsushita. See *ante*, at 879-880.

B

Every State's law on the preclusiveness of judgments is pervasively affected by the supreme law of the land. To be valid in the rendition forum, and entitled to recognition nationally, a state court's judgment must measure up to the requirements of the Fourteenth Amendment's Due Process Clause. *Kremer*, 456 U.S., at 482-483. "A State may not grant preclusive effect in its own courts to a constitutionally infirm judgment, and other state and federal courts are not required to accord full faith and credit to such a judgment." *Id.*, at 482 (footnote omitted).

In *Phillips Petroleum Co. v. Shutts*, this Court listed minimal procedural due process requirements a class-action money judgment must meet if it is to bind absentees; those requirements include notice, an opportunity to be heard, a right to opt out, and adequate representation. 472 U.S., at 812. "[T]he Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members." *Ibid.* (citing *Hansberry v. Lee*, 311 U.S. 32, 42-43, 45 (1940)). As the Court's phrase "at all times" indicates, the class representative's duty to represent absent class members adequately is a continuing one. 472 U.S., at 812; see also *Gonzales v. Cassidy*, 474 F.2d 67, 75 (CA5 1973) (representative's failure to pursue an appeal rendered initially adequate class representation inadequate, so that judgment did not bind the class).

Although emphasizing the constitutional significance of the adequate representation requirement, this Court has

recognized the first line responsibility of the States themselves for assuring that the constitutional essentials are met. See *Hansberry*, 311 U.S., at 42.[5] Final judgments, however, remain vulnerable to collateral attack for failure to satisfy the adequate representation requirement. See *id.*, at 40, 42; see also Restatement (Second) of Judgments §§ 42(d) and (e), Comments *e* and *f*, pp. 406, 410-412 (1982) (noting, *inter alia*, that judgment is not binding on purportedly represented person where, to the knowledge of the opposing party, the representative seeks to advance his own interest at the expense of the represented person); see also *id.*, § 41, Comment *a*, p. 394 (if § 42 circumstances exist, "the represented person may avoid being bound *either* by appearing in the action before rendition of the judgment *or* by attacking the judgment by subsequent proceedings"). (Emphasis added.) A court conducting an action cannot predetermine the res judicata effect of the judgment; that effect can be tested only in a subsequent action. See 7B C.

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5. Many States, including Delaware, have class-action rules corresponding to Federal Rule of Civil Procedure 23, a rule ranking adequacy of representation as a prerequisite to maintaining a class action. See 3 H. Newberg & A. Conte, Newberg on Class Actions, App. 13-1 (3d ed.1992) (listing 39 States and the District of Columbia with rules comparable to the amended Federal Rule of Civil Procedure 23); Fed. Rule Civ. Proc. 23(a)(4) (representatives may sue on behalf of the class only if "the representative parties will fairly and adequately protect the interests of the class"); see also *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 157-158, n. 13 (1982) (Federal Rule of Civil Procedure 23(a)(4)'s adequate representation requirement "raises concerns about the competency of class counsel and conflicts of interest," in addition to the question whether the representative shares the interests of the class members).

Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1789, p. 245 (2d ed.1986).

In Delaware, the constitutional due process requirement of adequate representation is embodied in Delaware Court of Chancery's Rule 23, a class-action rule modeled on its federal counterpart. *Prezant*, 636 A.2d, at 923, 920. Delaware requires, as a prerequisite to class certification, that the named plaintiffs "fairly and adequately protect the interests of the class." Del. Ch. Rule 23(a)(4). In *Prezant*, the Delaware Supreme Court considered whether adequate class representation was "a *sine qua non* for approval of a class action settlement," and concluded that it was. *Prezant*, 636 A.2d, at 920, 926. The state high court overturned a judgment and remanded a settlement because the Court of Chancery had failed to make an explicit finding of adequate representation. *Id.*, at 926.

The Delaware Supreme Court underscored that due process demands more than notice and an opportunity to opt-out; adequate representation, too, that court emphasized, is an essential ingredient. *Id.*, at 924 (citing *Phillips Petroleum Co. v. Shutts*, 472 U.S., at 812, 105 S.Ct., at 2974). Notice, the Delaware Supreme Court reasoned, cannot substitute for the thorough examination and informed negotiation an adequate representative would pursue *Prezant*, 636 A.2d, at 924. The court also recognized that opt-out rights "are infrequently utilized and usually economically impracticable." *Ibid.*

The Vice Chancellor's evaluation of the merits of the settlement could not bridge the gap, the Delaware Supreme

Court said, because an inadequate representative "taint[s]" the entire settlement process. *Id.*, at 925.[6] "[A]n adequate representative," the Delaware Supreme Court explained, "vigorously prosecuting an action without conflict and bargaining at arms-length, may present different facts and a different settlement proposal to the court than would an inadequate representative." *Ibid.* Consequently, the Delaware Supreme Court held, "*in every class action settlement*, the Court of Chancery is required to make an explicit determination on the record of the propriety of the class action according to the requisites of Rule 23(a) and (b)." *Ibid.*

In the instant case, the Epstein plaintiffs challenge the preclusive effect of the Delaware settlement, arguing that the Vice Chancellor never in fact made the constitutionally required determination of adequate representation. See *id.*, at 923.[7] They contend that the state court left unresolved

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6. In both *Prezant* and the instant case, a temporary settlement class device was used, telescoping the inquiry of adequate representation into the examination of the fairness of the settlement. According to the Delaware Supreme Court, however, this near simultaneity does *not* relieve the representative of her duty to demonstrate, nor the court of its duty to determine, the adequacy of representation. *Prezant*, 636 A.2d, at 923. In a comprehensive opinion, the Third Circuit reached the same conclusion after examining the temporary class settlement device in the context of Federal Rule of Civil Procedure 23. See *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 794-800 (1995).

7. The Vice Chancellor did not have the benefit of the Delaware Supreme Court's clear statement in *Prezant*, decided one year after

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key questions: notably, did the class representatives share substantial common interests with the absent class members, and did counsel in Delaware vigorously press the interests of the class in negotiating the settlement.[8] In particular, the Epstein plaintiffs question whether the Delaware class representatives — who filed the state lawsuit on September 26, 1990, two months before the November 26 tender offer announcement — actually tendered shares in December, thereby enabling them to litigate a Rule 14d-10 claim in federal court. They also suggest that the Delaware representatives undervalued the federal claims — claims they could only settle, but never litigate, in a Delaware court. Finally, the Epstein plaintiffs contend that the Vice Chancellor improperly shifted the burden of proof;[9] he

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this settlement was approved. In *Prezant*, however, the Delaware Supreme Court largely reiterated and applied what this Court had stated almost a decade earlier in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 808, 812 (1985). See also 2 R. Balotti & J. Finkelstein, Delaware Law of Corporations and Business Organization § 13.22, p. 13-131, and n. 578 (2d ed. 1996 Supp.).

8. The order approving the class for settlement purposes, the Epstein plaintiffs urge, contains no discussion of the adequacy of the representatives, see App. 198, and the order and final judgment approving the settlement contains only boilerplate language referring to the adequacy of representation, see *id.*, at 204-205. The Delaware Supreme Court approved the Court of Chancery's judgment in a one paragraph order. See *In re MCA, Inc. Shareholders Litigation*, 633 A.2d 370 (1993) (judgt. order).

9. Delaware law appears to place the burden of proof on the class representatives. See 2 Balotti & Finkelstein, *supra*, at 11, n. 7,
(Cont'd)

rejected the Delaware objectors' charges of "collusion" for want of evidence while acknowledging that "suspicions [of collusion] abound." *In re MCA, Inc. Shareholders Litigation*, 1993 WL 43024, at *5.[10]

Mindful that this is a court of final review and not first view, I do not address the merits of the Epstein plaintiffs' contentions, or Matsushita's counterargument that the issue of adequate representation was resolved by full and fair litigation in the Delaware Court of Chancery.[11] These

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§ 13-17, p. 13- 121 (class representative must prove satisfaction of Del. Ch. Rule 23(a) requirements, including adequacy of representation); see also 7A C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 1765, pp. 273-274, and n. 29 (2d ed.1986); 3B J. Moore, Moore's Federal Practice § 23.02-2 (2d ed.1995).

10. In this regard, it is noteworthy that Matsushita did not move to dismiss the Delaware action after the Vice Chancellor, in rejecting the first proposed settlement, surveyed the state-law claims and found them insubstantial. See *In re MCA, Inc. Shareholders Litigation*, 598 A.2d 687, 694 (Del. Ch. 1991) (Vice Chancellor described "the asserted state law claims" as "at best, extremely weak" and of "little or no value").

11. Counsel for Matsushita acknowledged that relief from a judgment may be sought in Delaware pursuant to that State's counterpart to Federal Rule of Civil Procedure 60(b). See Tr. of Oral Arg. 51-52; Del. Ch. Rule 60; see also 2 Newberg & Conte, *supra*, at 9, n. 5, §§ 11.27, 11.63 (Federal Rule of Civil Procedure 60(b) provides an avenue to challenge the adequacy of representation in a class settlement).

arguments remain open for airing on remand. I stress, however, the centrality of the procedural due process protection of adequate representation in class-action lawsuits, emphatically including those resolved by settlement. See generally J. Coffee, Suspect Settlements in Securities Litigation, N.Y.L.J., March 28, 1991, p. 5, col. 1.

APPENDIX B — ORDER AND FINAL JUDGMENT OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY DATED FEBRUARY 22, 1993 AND FILED FEBRUARY 23, 1993

IN THE COURT OF CHANCERY OF THE
STATE OF DELAWARE IN AND FOR
NEW CASTLE COUNTY

CONSOLIDATED
C.A. NO. 11740

IN RE MCA INC.
SHAREHOLDERS LITIGATION

ORDER AND FINAL JUDGMENT

On this 22 day of February, 1993, a hearing having been held before this Court to determine whether the terms of the Stipulation of Settlement dated October 22, 1992 (the "Stipulation"), and the terms and conditions of the settlement proposed in the Stipulation (the "Settlement"), and all transactions referred to therein or preparatory or incident thereto, are fair, reasonable and adequate for the settlement of all claims asserted herein; and whether judgment should be entered in these civil actions (the "Actions") dismissing the Actions on the merits with prejudice as against all of the plaintiffs and all members of the Settlement Class certified in this Court's Order dated October 27, 1992; and the Court having considered all matters submitted to it at the hearing and otherwise and the Court having rendered its Memorandum Opinion dated February 12, 1993 approving the Settlement and awarding attorneys' fees and expenses:

Appendix B

NOW, THEREFORE, IT IS HEREBY ORDERED THAT:

1. The Notice and Summary Notice (as defined in ¶ 4(b) of the Stipulation), is hereby determined to have been the best practicable notice under the circumstances and in full compliance with Rule 23 of the Court of Chancery and the requirements of due process and it is hereby further determined that the plaintiffs in the Actions, as representatives of the Settlement Class, have fairly and adequately protected the interests of the Settlement Class and that the maintenance of this action as a class action meets all the requirements of Rule 23(a) and (b)(3) of the Court of Chancery.

2. The Stipulation and the Settlement are approved as fair, reasonable and adequate and in the best interests of the plaintiffs and the Settlement Class, and the parties are directed to consummate the Settlement in accordance with the terms and provisions of the Stipulation, provided that any additional Requests for Exclusion received after the deadline set in paragraph 6 of the Hearing Order dated October 27, 1992 but prior to February 12, 1993 will be effective.

3. (a) The Actions are hereby dismissed with prejudice on the merits as to all defendants in the Actions (regardless of whether any such defendant has been served or entered an appearance in any of the Actions) and their respective present and former officers, directors, employees, agents, attorneys, financial advisors, commercial bank lenders, investment bankers, representatives, trustees, affiliates,

associates, parents, subsidiaries, general and limited partners and partnerships, heirs, executors, administrators, successors and assigns (including Lazard Freres & Co. (financial advisor to MCA), Allen & Co. Inc. (financial advisor to Matsushita) and Creative Artists Agency Inc. (advisor to Matsushita)) (collectively, the "Released Persons"), as against plaintiffs and all members of the Settlement Class (other than those who have validly requested exclusion therefrom) and their successors and assigns, whether known or unknown, whether directly or in any other capacity, without costs except as provided in the Stipulation, such dismissal to be subject only to compliance by the parties with the terms and conditions of the Stipulation and any Order of this Court with reference to the Stipulation.

(b) All claims, rights and causes of action (state or federal, including but not limited to claims arising under the federal securities laws, any rules or regulations promulgated thereunder, or otherwise), whether known or unknown that are, could have been or might in the future be asserted by any of the plaintiffs or any member of the Settlement Class (other than those who have validly requested exclusion therefrom), whether directly, derivatively, representatively or in any other capacity, against any of the Released Persons or against anyone else in connection with or that arise now or hereafter out of the Merger Agreement, the Tender Offer, the Distribution Agreement, the Capital Contribution Agreement, the employee compensation arrangements, the Tender Agreements, the Initial Proposed Settlement, this Settlement (except for compliance with the Settlement), or any matters, transactions or occurrences

referred to in the December 4, 1990 Claim Letter and the Amended Complaint in the Action, or the fiduciary or disclosure obligations of any of the Released Persons with respect to any of the foregoing, and including without limitation the claims asserted in the California Federal Actions, the Second Minton Action and the Second Epstein Action (all as defined in the Stipulation) (all of which are hereinafter collectively referred to as the "Settled Claims") are hereby compromised, settled, released and discharged with prejudice by virtue of the proceedings herein and this Order and Final Judgment.

4. The plaintiffs and all members of the Settlement Class (other than those who have validly requested exclusion therefrom), their successors and assigns, whether acting directly, derivatively, representatively or in any other capacity, are hereby permanently barred and enjoined from instituting or prosecuting any other action in any court of this or any other jurisdiction based upon, relating to, or for the purpose of enforcing any of the Settled Claims.

5. Plaintiffs' attorneys of record herein are hereby awarded the sum of $250,000 in fees and reimbursement of expenses in connection with the Actions, which sum the Court finds to be fair and reasonable and which shall be paid to plaintiffs' attorneys according to the terms set forth in the Stipulation. Said sum shall accrue interest and be paid in accordance with paragraph 8 of the Stipulation.

s/ [illegible]
Vice Chancellor

APPENDIX C — EXCERPTS FROM TRANSCRIPT OF ARGUMENT ON PLAINTIFFS' APPLICATION FOR APPROVAL OF A SETTLEMENT AND ATTORNEYS' FEES OF THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY DATED JANUARY 21, 1993

IN THE COURT OF CHANCERY OF THE
STATE OF DELAWARE IN AND FOR
NEW CASTLE COUNTY

C.A. No. 11740

IN RE MCA INC.
SHAREHOLDERS LITIGATION

Courtroom No. 106
Public Building
Wilmington, Delaware
Thursday, Jan. 21, 1993
12:04 p.m.

BEFORE: HON. MAURICE A. HARTNETT, III,
Vice Chancellor.

ARGUMENT ON PLAINTIFFS' APPLICATION
FOR APPROVAL OF A SETTLEMENT
AND ATTORNEYS' FEES

* * *

[49] MR. ALLYN: May it please the Court: My name is James Allyn. I represent the objector, William Krupman.

Appendix C

Vice Chancellor, this settlement is not fair and it should not be approved. In explaining why, I will first describe how Mr. Krupman and I came to be here today, since you have heard allegations that he and I are pawns or straw men of the Kaufman Malchman firm.

I am a solo general practitioner in New York City. It is an honor for me to be here in this courtroom with these distinguished lawyers today. I am not an expert in securities litigation. Does that buttress their claim that he and I are pawns of Kaufman Malchman? No. In fact, it rebuts that claim, as I will explain.

Mr. Krupman is my father-in-law. We have an excellent relationship. That also means that my expected reimbursement for fees and expenses in this matter is about $691,000 less than what the plaintiffs' attorneys seek.

How did Mr. Krupman come to be an objector here? In November he asked me to review a proposed settlement that was submitted to him. [50] At the end of November at a family dinner he asked me what I thought about it. I did some calculations and came up with the number that he was being offered $2 a share. Fortunately, another relative who is an accountant was there, and he came up with the correct figure of two cents a share. I told him that the attorneys were going to submit an application to get $600,000 in fees.

Mr. Krupman was extremely upset. He believes that MCA was worth more than it was sold for. The deal happened at the price due to an extremely generous compensation package which was received by the directors. He felt the tender offer was inadequate and now he was being presented

with a settlement that was inadequate. He asked me to find out how to register his displeasure.

A few days later he gave me the name of a gentleman named Ernest Kaufman in Los Angeles, and asked me to call him for information. I called Mr. Kaufman at the beginning of December. I left a message that I wanted to talk about the MCA case. He never called me back.

Being busy with other matters such as making a living, I did not call Mr. Kaufman again, [51] which is a demonstration of inertia that occurs even among those who wish to object to a settlement.

In mid-December a friend called me up. He asked me to initiate a class action against National Health Laboratories, whose stock had plummeted after they pled guilty to defrauding the government. I explained to my friend that I was not qualified to handle such litigation, given the size of my practice and the level of my experience. I requested that that person send me a copy of the complaint in the matter.

Returning to my office after Christmas, on my desk was a letter from Mr. Jeffrey Squire of the Kaufman Malchman firm. It turned out that his firm had handled the National Health Laboratories matter. He enclosed a copy of the complaint, along with a cover letter stating that I should feel free to call him if I had any questions about the complaint or if I wanted to discuss securities litigation in general.

I called and left a message for him to thank him for sending me the materials. I also noticed that he was from the Kaufman Malchman firm, the same firm as Ernest Kaufman in Los Angeles.

[52] Mr. Squire was on vacation. However, I left a message. He returned my call nonetheless. I thanked him. I then asked him if he knew anything about MCA. I told him that Mr. Krupman was very displeased and if there was anything he could do, I asked him for ideas and advice on how to contest the settlement. We discussed the case, and Mr. Squire offered to provide materials to use in drawing up an objection. He sent me the Exhibits B through K, which are mainly the federal appeals briefs, which are attached to Mr. Krupman's affidavit, plus a draft objection.

I reviewed these and then called Peter Linden at the Kaufman firm to further discuss them. I edited the draft, typed it into my computer. I then discarded the draft that Kaufman Malchman had provided to me. I printed my own draft, and went through this process a number of times, revising my drafts each time. I do not have a copy of what Kaufman Malchman gave me. I have since stated that in a document request which was made to Mr. Krupman. I asked Kaufman Malchman to provide me with a copy, but they are unable to do so.

I then showed the draft affidavit to [53] Mr. Krupman. I discussed the case with him. He revised the affidavit. I made those changes, and we submitted the affidavit.

The settlement proponents now say that we are a pawn of Kaufman Malchman. That is very ironic to me. We serendipitously came into contact with them after Mr. Kaufman in Los Angeles did not return my initial phone call.

* * * *

APPENDIX D — AMENDED STOCKHOLDERS' CLASS ACTION COMPLAINT DATED AND FILED DECEMBER 14, 1990

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY

CONSOLIDATED CIVIL ACTION NO. 11740

IN RE:

MCA INC. SHAREHOLDERS LITIGATION

AMENDED STOCKHOLDERS' CLASS ACTION COMPLAINT

Plaintiffs allege upon information and belief, except for paragraph 5 which is alleged upon knowledge, as follows:

NATURE OF THE ACTION

1. This is a stockholders' class action on behalf of the public stockholders of MCA Inc. ("MCA" or the "Company") who are being deprived of the opportunity to maximize the value of their MCA common stock in the sale of the Company. This Amended Stockholders' Class Action Complaint (the "Amended Complaint") is being filed pursuant to the Stipulation and Order governing scheduling in this action. The Amended Complaint incorporates plaintiffs' allegations against defendants as set forth in a letter dated December 4, 1990, from Steven Schulman, Esquire, to Herbert M. Wachtell, Esquire.

2. As more fully described herein, on November 26, 1990, defendants Lew R. Wasserman ("Wasserman") and Sidney Jay Sheinberg ("Sheinberg"), together with other members of MCA senior management and their advisors, entered into a merger agreement which provides for the sale of MCA to Matsushita Electric Industrial Co. ("Matsushita"), a Japanese corporation and one of the world's largest consumer electronic manufacturers (the "Merger"). As part of the Merger, Matsushita commenced a tender offer to MCA's stockholders on November 30, 1990, for all of MCA's common stock at a price of $66 per share plus a purportedly pro rata distribution of the stock of one of MCA's businesses, WWOR-TV (the "Tender Offer"). The Tender Offer expires by its terms on December 29, 1990.

3. The decision by defendants to sell the Company imposes upon them fundamental fiduciary duties to disclose all material facts to the Company's stockholders with complete candor and to seek the best possible transaction for the stockholders through implementation of bidding mechanisms or the exploration of strategic alternatives designed to assure the maximization of stockholder value. MCA's board of directors (named as defendants in this action) have been and are breaching their fiduciary duties to the stockholders of MCA by, inter alia, (1) failing adequately to disclose to MCA's stockholders material facts necessary to make an informed decision about the Tender Offer and Merger, including substantial conflicts of interest involving defendants Wasserman and other MCA senior management and MCA's Board of Directors, the future status of WWOR-TV, prior market contacts from other potential purchasers of MCA, and other material information, (2) giving

preferential treatment to defendant Wasserman by paying him preferred stock rather than the consideration paid to the public stockholders, and (3) negotiating and entering the Merger agreement on a preferential basis with Matsushita and failing to implement the auction or other bidding mechanisms or market check procedures necessary to assure that the stockholders receive the highest possible price in connection with the change in control.

4. The Merger is designed by the Individual Defendants and other members of MCA senior management to entrench the officers and directors of MCA in the management and control of MCA and to advance their own personal interests at the expense of MCA's public stockholders. Indeed, the Merger represents the culmination of a series of steps which the Individual Defendants have taken to deter and ultimately thwart any unsolicited expression of interest to acquire the Company which they have not initiated or approved. In furtherance of these efforts, the Individual Defendants over the last several years have adopted and utilized an array of defensive weapons, including (a) a "poison pill" created for the purpose of discouraging unsolicited takeover attempts and usurping from MCA's stockholders the power to accept or reject any proposal for the purchase of their shares; (b) lucrative severance agreements (or "golden parachutes") to several executive officers of the Company; and (c) a "staggered" board intended to deter any unsolicited acquisition efforts.

5. The Individual Defendants and other members of MCA senior management with whom they are allied are attempting to transfer the entire ownership and control of

the Company's outstanding shares at a price substantially below their fair and intrinsic value, in order to gain valuable personal benefits from Matsushita in the Merger. As shown herein, the Merger and Tender Offer are timed to take advantage of a recent serious decline in the market value of MCA's common stock resulting from a temporary and reversible decline in revenues and net income caused inter alia, by the Company's expansion plan and a temporary market decline due to world events, including the Persian Gulf crisis. The long-term benefits which will result from this plan vastly exceed the immediate costs and burdens involved in developing these business opportunities and demonstrate that Matsushita in conjunction with the Individual Defendants is attempting to appropriate for itself the future growth and profitability of this entertainment giant without providing adequate disclosure of material information and obtaining fair and adequate consideration for the MCA public stockholders.

6. Preliminary and permanent injunctive relief and other equitable remedies are necessary to protect MCA public stockholders from the immediately threatened divestiture of their equity interest in MCA under circumstances representing a gross deviation from the enhanced fiduciary responsibilities which Delaware law imposes in connection with the sale of a company or any other fundamental change in corporate control.

THE PARTIES

7. Plaintiffs are owners of shares of common stock of MCA who have been damaged and are threatened with

further injury by the wrongful actions of the defendants as set forth below. They bring this action as a class action on behalf of the public stockholders of MCA.

8. Defendant MCA is a Delaware corporation that maintains its principal executive offices in Universal City, California. MCA is an international concern engaged in the production and distribution of theatrical, non-theatrical, television and home video products; licensing of merchandising rights and film property publishing rights; manufacture and distribution of recorded music and music publishing; operation of amphitheaters; manufacturing and licensing of entertainment/sports apparel, non-consumable concessions for sports/entertainment events and other music entertainment activities; retailing and mail order of gift merchandise; book publishing; television broadcasting; recreation services; and real estate development.

9. At all relevant times herein, each of the following defendants (collectively, the "Individual Defendants") were directors of MCA and/or senior officers of MCA.

a. Lew R. Wasserman is Chairman of the Board, Chief Executive Officer and a member of the Executive Committee. Wasserman's current annual salary is approximately $900,000. Wasserman also owned as of January 31, 1990 over 4.9 million shares of MCA common stock representing approximately 6.7% of the common shares outstanding. In connection with the Merger, Wasserman will receive an enhanced salary of at least $3 million annually, as well as preferred stock in Holding that will pay him a cash dividend exceeding $28 million annually.

b. Sidney Jay Sheinberg ("Sheinberg") is a Director, President and Chief Operating Officer and a member of the Executive Committee. Sheinberg's current annual salary is approximately $900,000. Sheinberg also owned as of January 31, 1990, approximately 1.3 million shares of MCA common stock, representing approximately 1.8% of the common shares outstanding. In connection with the Merger, Sheinberg will receive an enhanced salary of over $8 million annually, plus a cash bonus of $21 million.

c. Thomas P. Pollock ("Pollock") is a Director and Executive Vice President. Pollock's current annual salary is $850,000. Pollock also owned as of January 31, 1990, 144,240 shares of MCA common stock, representing approximately .02% of the amount of common shares outstanding. As part of the Merger, Pollock will receive $16.7 million in bonuses and incentives.

d. Thomas Wertheimer ("Wertheimer") is a Director, Executive Vice President and a member of the Executive Committee. Wertheimer's current annual salary is $650,000. Wertheimer also owned as of January 31, 1990, 227,235 shares of MCA common stock, representing approximately .03% of the amount of common shares outstanding. In connection with the Merger, Wertheimer will receive $7.7 million in bonuses and incentives.

e. Charles S. Paul ("Paul") is a Director and President of MCA Enterprises, a subsidiary of MCA. In

connection with the Merger, Paul will receive $12.3 million in bonuses and incentives.

f. Howard H. Baker ("Baker"), a Director, is a Partner in the law firm of Baker, Worthington, Crossley, Stansberry & Woolf. Baker's firm will receive substantial compensation from MCA for services purportedly rendered in the Tender Offer and Merger.

g. Robert S. Strauss, a Director, is a Partner in the law firm of Akin, Gump, Strauss, Hauer & Feld. Strauss' firm represented both MCA and Matsushita in connection with the Tender Offer and Merger. His firm will receive $8 million from MCA for its services purportedly rendered in connection with the challenged transaction, and an undisclosed sum for its representation of Matsushita.

h. Felix G. Rohatyn, a Director, is a General Partner of Lazard Freres & Co. ("Lazard") which served as the principal financial advisor to MCA, and delivered a "fairness opinion" in connection with the Tender Offer and Merger, for which Lazard will receive over $16.8 million in the event that a sale of the Company is accomplished.

i. Defendants Thomas V. Jones, Howard P. Allen, and Mary Gardiner Jones are each members of MCA's Board of Directors. These directors receive annual directors' compensation of $18,000, plus $18,000 per year for each committee on which they serve, and $1,500 for each directors' and committee meeting they attend.

10. Defendant Matsushita, a company organized under the laws of Japan, is one of the world's largest producers of consumer electronic and electric products with sales in fiscal 1990 of more than $37 billion. Matsushita operates 117 companies in 39 countries. Matsushita's principal executive offices are located in Osaka, Japan. Defendant Matsushita Acquisition Corp. ("Acquisition"), a Delaware corporation and a wholly-owned subsidiary of defendant Matsushita Holding Corp. ("Holding"), also a Delaware corporation, has been incorporated for the purpose of purchasing all the common stock of MCA. Under Section 6.17 of the Merger Agreement, defendants Matsushita, Acquisition and Holding submit to the personal jurisdiction of this Court.

11. All officers and directors of MCA, as a group, including the Individual Defendants, beneficially owned over 7 million shares of MCA common stock, or nearly 10% of MCA's common stock outstanding as of January 31, 1990.

12. By virtue of their positions as directors and/or officers of MCA and their exercise of control over the business and corporate affairs of MCA, the Individual Defendants have and at all relevant times had the power to control and influence, and did control and influence and cause MCA to engage in the practices complained of herein. Each Individual Defendant owed and owes MCA and its stockholders fiduciary obligations and were and are required to: fulfil their duty of candor to the stockholders by making timely and adequate disclosures in press releases and in the materials filed with the Securities Exchange Commission ("S.E.C.") in connection with the Tender Offer and Merger, including Schedules 14D-1 and 14D-9; use their ability to

control and manage MCA in a fair, just and equitable manner; act in furtherance of the best interests of MCA and its stockholders; act to maximize stockholder value; govern MCA in such a manner as to heed the expressed views of its public shareholders; refrain from abusing their positions of control; and not to favor their own interests at the expense of MCA and its stockholders. MCA has distributed the Offer to Purchase to its stockholders together with the Schedule 14D-9 and Matsushita has the right to "review and comment" upon disclosure materials of MCA in connection with the Tender Offer and Merger. Therefore, all defendants are jointly responsible for the inadequate disclosures provided to MCA stockholders in connection with the challenged transactions.

13. By virtue of the acts and conduct alleged herein, the Individual Defendants, who control the actions of the Company, are breaching their fiduciary duties to the public stockholders of MCA.

14. The Individual Defendants are sued individually as conspirators and aiders and abettors, as well as in their capacity as officers and/or directors of the Company, and the liability of each arises from the fact that they have engaged in all or part of the unlawful acts, plans, schemes or transactions complained of herein.

15. Matsushita, Acquisition and Holding are acting in concert with the Individual Defendants and are sued as conspirators and aiders and abettors of the Individual Defendants.

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CLASS ACTION ALLEGATIONS

16. Plaintiffs bring this action pursuant to Rule 23 of the Rules of the Court of Chancery on behalf of themselves and all other stockholders of MCA, or their successors in interest (the "Class"). Excluded from the Class are the defendants, members of the immediate families of the Individual Defendants or their representatives, and directors, officers, subsidiaries, controlled affiliates, and partners of any of the defendants.

17. The action is properly maintainable as a class action for the following reasons:

a. The Class is so numerous that joinder of all members is impracticable. As of January 31, 1990, MCA had in excess of 73,000,000 shares of common stock outstanding held by thousands of stockholders of record and beneficial owners;

b. The members of the Class are scattered throughout the United States and are so numerous as to make it impractical to bring all of them before this Court;

c. There are questions of law and fact which are common to the Class and which predominate over questions affecting only individual Class members. The common questions include, inter alia, the following:

i) whether the Individual Defendants have breached their fiduciary obligations to plaintiffs and the other members of the Class by failing and

refusing to attempt in good faith to maximize stockholder value in the sale of the Company;

ii) whether the Individual Defendants have breached the fiduciary and other common law duties including the duty of complete candor owed by them to plaintiffs and the other members of the Class; and

iii) whether defendants have subjected MCA to potential liability under S.E.C. Rules 14d-7, 14d-10, 10b-13 and 13e-3, promulgated under the Securities and Exchange Act of 1934 (the "Exchange Act"), thereby causing MCA to expend and waste corporate assets that could have been distributed for the benefit of MCA's public stockholders; and

iv) whether plaintiffs and the other members of the Class are being or will continue to be injured by the wrongful conduct alleged herein and, if so, what is the proper remedy and/or measure of damages.

18. Plaintiffs are committed to prosecuting this action and have retained competent counsel experienced in litigation of this nature. The claims of plaintiffs are typical of the claims of other members of the Class and plaintiffs have the same interests as the other Class members.

19. A class action is superior to other available methods for the fair and efficient adjudication of this action, and no unusual difficulties are likely to be encountered in the

management of this class action. The likelihood of individual Class members prosecuting separate claims is remote.

20. Defendants have acted and are about to act on grounds generally applicable to the Class, thereby making appropriate final injunctive or corresponding declaratory relief with respect to the Class as a whole.

BACKGROUND

21. MCA is a recognized leader in the entertainment industry operating in six major business segments: film entertainment (51% of 1989 revenues of $3.4 billion); music entertainment (23%); retail and mail order (8%); book publishing (6%); broadcasting and cable (5%); and other operations (7%). MCA has had outstanding financial results in recent years as evidenced by the growth in sales and earnings as summarized below:

MCA Five Year Summary
(all figures in thousands except growth rate and EPS)

Year	Sales	Net Income	EPS(S)
1989	3,382,344	191,773	2.62
1988	2,900,339	164,916	2.26
1987	2,479,105	137,254	1.82
1986	2,230,018	150,904	1.97
1985	2,021,078	149,959	2.02
5-Year Growth Rate (%)	13.70	6.30	6.70

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22. In June 1989, the Company opened its new Universal Florida theme park which will operate in direct competition with the Disney World facility in Orlando, Florida. MCA also scored a recent coup when it paid the equivalent of $550 million in preferred stock for Geffen Records, a leading member of the recording industry. It also owns WWOR-TV, an independent New York area television station, and has a 50% stake in the cable USA Network.

23. On July 19, 1990, defendant Wasserman announced that for both the three and six months ended June 30, 1990, the Company reported record second quarter and first half revenues and higher net income than the comparable periods of 1989. Revenues for the second quarter of 1990 were $949,942,000 compared to $828,256,000 for 1989. Net income was $44,781,000 or $0.54 per share compared to $41,972,000 or $0.58 per share for 1989. The weighted average number of common and common equivalent shares used in the determination of earnings per share for the three months ended June 30, 1990 and 1989 was 83,245,493 and 73,142,872, respectively. The 1990 calculations of earnings per share include the equivalent common shares for the Company's Series B convertible preferred shares issued during the second quarter of 1990 in connection with the Geffen acquisition.

24. Similarly, revenues for the first half of 1990 were $1,862,888 compared to $1,531,602 for 1989. Net income was $76,359,000 or $0.96 per share compared to $69,313,000 or $0.95 per share for 1989.

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25. MCA's film entertainment group reported record revenues and operating incomes in the second quarter of 1990. The music entertainment group also reported record revenues and operating income for the second quarter of 1990. Broadcasting and cable reported record revenues and operating incomes in the second quarter of 1990 due to improved results for WWOR-TV and the USA Network. Retail and mail order had higher revenues in 1990 due to higher retail store sales.

26. The fiscal 1989 financial statements show that MCA's financial condition is also strong. The current ratio (current assets: current liabilities) was above 2X as it had been during the two years previous while the Company's debt/equity ratio decreased from 0.79 to an even more conservative 0.65.

27. Recognizing the strength of MCA's assets and the quality of its operations, industry financial analysts have conservatively valued MCA at up to $100 per share. However, MCA, like other media and entertainment companies, has recently suffered a serious decline on Wall Street. Since July, 1990, the market value of the stock has declined from a high of approximately $64 per share to as low as $34 per share immediately prior to the announcement of a prospective transaction with Matsushita. The decline in the value of the stock was accelerated by reports concerning problems incident to the opening of the vast new theme park in Orlando, Florida, the perceived dilution caused by the issuance of substantial additional shares to the Geffen interests in connection with the Geffen acquisition, and the overall market decline attributed to the Persian Gulf crisis.

These factors are temporary and reversible and do not detract from the impressive long-term strengths of the Company.

28. On September 25, 1990, the Wall Street Journal reported that Matsushita was negotiating with MCA over an acquisition transaction involving the entertainment giant. Both MCA and Matsushita thereafter publicly confirmed that representatives of the respective companies were involved in negotiations regarding a prospective change in control transaction. According to published reports, the widespread perception among major stock traders and financial analysts was that an announcement of a sale transaction was imminent. Reflecting these expectations, the market price of MCA common stock surged dramatically upward immediately upon announcement of these events from $34 1/2 per share to close at $54 per share on September 25, 1990, a net increase of 57%.

29. On September 26, 1990, plaintiffs filed their original Shareholders' Class Action Complaint (the "Original Complaint"). The Original Complaint sought injunctive and declaratory relief, as well as money damages, against an improper transaction between MCA and Matsushita.

30. On November 26, 1990, MCA entered into an Agreement of Merger with Matsushita. Under the Merger Agreement, Acquisition on November 30, 1990 commenced the Tender Offer to purchase all of MCA's common stock at a price of $66.00 per share in cash. On the same day, defendants filed Schedules 14D-1 and 14D-9 with the S.E.C. and distributed to MCA's stockholders the Offer to Purchase. The Tender Offer expires on December 29, 1990. The Merger

Agreement also calls for MCA to spin off to its stockholders, on a purportedly pro rata basis, its interest in the television station WWOR-TV.

31. In addition, the principals to the transaction have negotiated and entered into a series of other transactions and agreements, including the following:

a) The Option Agreement, which provides for MCA to grant to Matsushita an irrevocable option to purchase 16,880,788 shares of MCA stock at a price of $71 per share in the event that (1) a third party commences a tender offer for 50% or more of MCA's stock, (2) a third party acquires 33% or more of MCA's stock, or (3) the MCA Board withdraws or modifies its recommendation or approval of the Merger;

b) The Capital Contribution Agreement, which provides for defendant Wasserman to contribute 4,953,927 shares of MCA stock to Holding in exchange for Holding preferred stock. Under this agreement, Wasserman, unlike the public stockholders of MCA, will receive consideration for his MCA stock in a tax-free transaction;

c) The Tender Agreements, which provide for defendants Sheinberg and Geffen to tender their MCA stock into the Tender Offer; and

d) The Distribution Agreement, which provides for MCA to spin off WWOR-TV to its stockholders. The Distribution agreement also calls for WWOR-TV to adopt a

"share purchase rights plan," or poison pill, acceptable to defendants following the Merger.

32. As detailed in paragraph 9, above, the Merger also provides for substantial payments and other benefits for certain of the Individual Defendants that will not be shared by MCA's public stockholders. For example, defendant Sheinberg will receive a $21 million cash bonus, plus a reported $9.6 million in "incentive awards." Sheinberg also will receive an enhanced salary of $8.6 million per year under the Merger Agreement, up from approximately $900,000 under his prior contract with MCA. Defendant Wasserman will receive an enhanced salary of at least $3 million per year under the Merger Agreement, up from less than $900,000 under his prior contract with MCA.

33. Additionally, defendant Wasserman, unlike the public stockholders of MCA, also will receive new preferred stock in Holding in order to reap the substantial, additional benefits of a tax-free transaction. MCA's public stockholders do not have the opportunity to participate in any such tax-free exchange. Defendant Wasserman's Holding preferred stock will pay a dividend of $28.6 million per year, up from the over $3 million he currently receives annually. Finally, other senior officers of MCA will receive "bonuses" and "incentives" totalling almost $55 million in the Merger, as described above in paragraph 9.

34. The Tender Offer and Merger are timed to take advantage of a temporary downturn in the price of MCA common stock. MCA's stock price has recently declined primarily due to the initial problems experienced in opening

the Florida theme park, the dilutive impact of the Geffen acquisition, and temporary world economic conditions. Shortly prior to announcement of the Merger discussions in September, 1990, MCA stock traded at approximately $34 to $35 per share. However, in 1989, the stock traded at prices considerably above the $66 Tender Offer price. The Tender Offer and Merger will occur at a time when the Company is poised to enjoy significantly increased earnings in the future, as the operations of the Florida theme park are stabilized and the beneficial impact of the Geffen acquisition is realized.

35. The intrinsic value of the Company materially exceeds the $66.00 per share and WWOR-TV stock value which Matsushita will pay in the Tender Offer. Given the Company's potential growth and profitability, the underlying strength of its assets, growth plans, resources and accessibility to public and private financing, the price to be paid to the public stockholders is unfair and inadequate.

DEFENDANTS' BREACHES OF THEIR DUTY OF CANDOR

36. Defendants have breached and continue to breach their duties of candor to MCA's public stockholders by failing to disclose adequately material information concerning the Tender Offer and Merger. Under Section 4.06 of the Merger Agreement, MCA has the opportunity to review and comment upon Matsushita's Offer to Purchase and Schedule 14D-1. Moreover, all defendants acted in concert with and/or aided and abetted one another in filing and disseminating Matsushita's Offer to Purchase, Schedule 14D-1 and Schedule 14D-9. Finally, MCA's 14D-9

disseminated the Offer to Purchase as an exhibit thereto. Therefore, all defendants are responsible jointly for the inadequate and misleading disclosures provided to MCA's stockholders in connection with the Tender Offer and Merger.

37. Defendants have breached their duties of candor to MCA's public stockholders by failing to disclose adequately the nature and circumstances of the substantial benefits that the Individual Defendants will receive in the Merger. The Offer to Purchase and Schedules 14D-1 and 14D-9 give the misleading impression that Sheinberg's, Wasserman's and certain of the other Individual Defendants' lucrative employment and bonus agreements, as described above in paragraph 9, were imposed "as a condition to Matsushita's willingness to agree to enter the Merger Agreement. . . ." and are not substantially greater than they would be if not for the Merger (See Offer to Purchase; Schedule 14D-9 at 23-26). In fact, Sheinberg's, Wasserman's and the other Individual Defendants' personal benefits from the Merger were insisted upon by MCA management as the price of its willingness to negotiate with Matsushita and are far greater than the Individual Defendants could have expected to receive in the ordinary course. Matsushita willingly agreed to pay, and encouraged the payment of, such compensation because of its expectation that this would vastly limit the independence of senior management and the MCA Board in negotiating with Matsushita and thereby save the purchaser potentially hundreds of millions or billions of dollars in acquisition costs that a fully disinterested MCA Board would have insisted upon. The portrayal of the management benefits as consistent with ordinary practice and as proceeding from the wishes of the purchaser to secure the services of the

present MCA officers and directors is materially false and deceptive and calculated to present a neutral or positive impression of special arrangements, which create serious conflicts of interest that the defendants have attempted to conceal.

38. Defendants also have breached their duties of candor by failing adequately to disclose their intention to retain de facto control over WWOR-TV following the spinoff of that entity to MCA's stockholders in the Merger. The Offer to Purchase and Schedules 14D-1 and 14D-9 falsely suggests that WWOR-TV could be put up for sale on the basis of competitive bidding following the Merger. In fact, the provision in the Merger for a board of directors following the spinoff that will be dominated by MCA management and the planned implementation of a shareholder rights plan, or "poison pill" have both the purpose and effect of entrenching in the control of WWOR-TV the MCA designees, and preventing a sale of the television station on the basis of effective and competitive bidding.

39. Additionally, defendants have breached their duty of candor to MCA's public stockholders by failing adequately to disclose significant and material information about the various operating segments of MCA that has been concealed from the public stockholders but provided exclusively to Matsushita. The Schedule 14D-9 creates the false impression that such information would not be "material" to MCA's stockholders. In fact, such concealed information would be of significance to MCA stockholders who must make an informed election between exchanging their shares in the Tender Offer or Merger and a statutory appraisal proceeding.

Defendants' failure to disclose both the material nature of this information and the information itself constitute breaches of defendants' duty of candor.

40. Defendants also have breached their duty of candor by failing to disclose prior market contacts between MCA and other potential purchasers which would indicate to MCA's stockholders the level of market interest MCA could attract in an open and effective auction. The Offer to Purchase and Schedules 14D-1 and 14D-9 falsely indicate that "no party other than Matsushita had made or expressed any interest in making a proposal to acquire the Company . . . ." (See, e.g., Schedule 14D-9 at 40). Defendants have failed to disclose that interested purchasers were rebuffed by defendants when such potential purchasers refused to grant the Individual Defendants the generous personal benefits granted by Matsushita. Such information would materially assist MCA's stockholders in assessing the fairness and adequacy of the Tender Offer and Merger.

41. Finally, defendant Wasserman's equity participation in Holdings following the Merger demonstrates that the parties are engaged in a form of "going private" transaction subject to the disclosure requirements of S.E.C. Rule 13e-3, promulgated under the Exchange Act. However, defendants have not made the required filings with the S.E.C. which would be required to be made were they proceeding in accordance with Rule 13e-3. In particular, the Lazard investment banker's "book" has not been made publicly available as would otherwise be the case were the parties proceeding in accordance with the requirements of Rule 13e-3. Material information regarding the fairness and adequacy

of the proposed transaction has thus been withheld from the investing public. Delaware fiduciary duties of complete candor incorporate the requirement to make available in a "going private" transaction the materials required by Rule 13e-3.

DEFENDANTS' BREACHES OF THEIR FIDUCIARY DUTIES TO MAXIMIZE STOCKHOLDER VALUES AND ACT IN THE BEST INTERESTS OF THE STOCKHOLDERS

42. Defendants owe fundamental fiduciary obligations of complete candor to the Company's stockholders in connection with the Tender Offer and Merger. Defendants also owe fundamental fiduciary obligations to the Company's stockholders to take all necessary and appropriate steps to maximize the value of their shares in implementing such a transaction. In addition, the Individual Defendants have the responsibility to act independently so that the interests of MCA's public stockholders will be protected, and to conduct fair and active bidding procedures or other mechanisms for checking the market to assure that the highest possible price is achieved. Further, the directors of the Company must adequately insure that no conflict of interest exists between defendants' own interests and their fiduciary obligations to maximize stockholder value or, if such conflicts exists, to insure that all such conflicts will be resolved in the best interest of the Company's public stockholders.

43. In breach of their fiduciary duty, a majority of the MCA Board of Directors have financial or other conflicting interests in the success of the transaction. Senior management

are eligible to receive bonus and compensation payments immensely greater than they would otherwise receive under their present contracts. Mr. Wasserman has negotiated a very favorable agreement in connection with the Merger which will insulate him from costly taxes. Defendant Baker faces a significant conflict of interest because of substantial payments made to his law firm in connection with the Merger. Defendant Strauss similarly faces a substantial conflict of interest because of the dual representation by his law firm of Matsushita and MCA and in fact participated in the deliberations of the Board regarding the Tender Offer and Merger, although abstaining from voting on the Merger. Defendant Rohatyn cannot claim any objectivity with respect to his support for the Merger because of the multi-million dollar fees which Lazard — the principal financial advisor in the Merger and a firm in which Rohatyn is a General Partner — will receive in the event that the Merger is consummated. In addition, Lazard's "fairness" opinion is unreliable because of the agreement which Lazard has arranged, by which Lazard receives multi-million dollar advisory fees contingent upon the completion of the acquisition transaction.

44. MCA represents a highly attractive acquisition candidate which has drawn the interest of such international business enterprises as General Electric Co., and Capital Cities/ABC Inc., both of which were reportedly willing to pay in excess of $90 per share in an acquisition transaction. Additionally, MGM/Pathe Communications Corp. appears to have been rebuffed in its efforts to negotiate a higher offer with defendants. The preferential treatment accorded Matsushita by the Individual Defendants for their own gain

has deprived and will continue to deprive the MCA public stockholders of the very substantial premiums which proper exposure of the Company to the market could have provided.

45. The Individual Defendants have breached their fiduciary and other common law duties owed to plaintiffs and the other members of the Class in that they have not and are not exercising independent business judgment and have acted and are acting to the detriment of the Class in order to benefit themselves and other members of MCA senior management acting in concert with Matsushita.

46. As reported in the September 25, 1990 Wall Street Journal article prior to the merger agreement, "any transaction would have to have the blessing of Wasserman," MCA's Chairman of the Board. Defendant Wasserman, who is 77 years old, owns almost 7% of the outstanding common shares of the Company. In addition, the Wall Street Journal article reported that Matsushita "wants to keep MCA management in place" in conjunction with an acquisition transaction. More importantly, the lucrative salary, bonus and "incentive" agreements between Matsushita and the Individual Defendants as well as the preferential treatment accorded defendant Wasserman have deprived the Individual Defendants of their ability to judge independently and fairly the value of MCA. As a result, the Merger is not the product of arm's length negotiations and is not based upon any independent evaluation of the current value of MCA's common stock, assets or business. Rather, the Merger and Tender Offer price is being fixed arbitrarily by Matsushita in conjunction with MCA senior management as part of their unlawful plan and scheme to obtain the entire ownership of

the Company's assets and business at an unfair and inadequate price.

47. Contrary to normal and established procedures in implementing such transactions, defendants have apparently failed to created any "Special Committee" of fully independent and disinterested directors who will act objectively and in the sole and ultimate best interests of all stockholders in effectuating the sale of the Company.

48. Under the terms of the Capital Contribution Agreement, defendant Wasserman will receive preferred stock in a subsidiary of Matsushita in exchange for his holdings of MCA shares. The purpose of this agreement is to afford defendant Wasserman tax-free treatment not available to other shareholders, and to save Wasserman millions of dollars in taxes that would be due if he received cash. By providing defendant Wasserman with this preferential treatment in the acquisition, and by assuring that Wasserman received greater value per share than that available to other MCA shareholders, the Individual Defendants have breached their duty of loyalty to MCA and its stockholders and all defendants have effected illegal and impermissible discrimination among MCA's stockholders and the shares they hold.

49. The Individual Defendants have also failed to engage in a sufficient "market check" necessary to assure the fairness and adequacy of the Tender Offer and Merger terms. Since the commencement of discussions and negotiations with Matsushita in or about September 1990, MCA has been prevented from soliciting any competitive

expressions of interest or purchase proposals. In addition, the parties have clearly rejected any post-agreement "market check" by virtue of their refusal to extend the Tender Offer beyond the minimum required under federal regulations, by their adoption of the Option Agreement which provides Matsushita with a "lock-up" option, and by agreeing to break-up fees amounting to $125 million, among other restraints that prevent any genuine auction from developing. MCA remains prohibited from soliciting competitive expressions of interest and, while MCA may respond to any competitive proposals which are made, the limited time available and obvious allegiances of management and the Board of Directors inevitably will discourage genuine competitive bids from emerging.

50. Certain other aspects of the transaction confirm the fundamental failure of the MCA directors to obtain the best possible transaction unaffected by conflicts of interest. In order to facilitate the transaction with Matsushita, defendants have arranged to spinoff the WWOR-TV subsidiary to stockholders rather than investing the additional time and effort necessary to auction this subsidiary at the highest possible price and thereby generate maximum proceeds for the shareholders. In addition, the Distribution Agreement contemplates that the spun off company will adopt a "poison pill" in form acceptable to Matsushita and MCA. If this subsidiary were genuinely to be independent, it would be unnecessary to incorporate such provision in the agreements. The implementation of the poison pill under these circumstances is intended to prevent the emergence of an open and effective auction for the television station and to

assure that those persons chosen by the principals to manage the station will confront no challenge to their control.

51. Moreover, the MCA directors have agreed to an arrangement whereby the Yosemite subsidiary will be marketed at some later time and its earnings prior to the sale will be placed in escrow for the benefit of the National Park Service. The escrowing of the Yosemite profits for an indeterminate period is clearly calculated to assuage public sentiment concerning the transaction and allow the defendants to achieve their personal agenda in consummating the sale under the agreed terms. A sale to another purchaser may not engender such public sensitivities and under those circumstances, the value of the Yosemite subsidiary would unquestionably be reserved for the shareholders.

52. Defendants also have failed or refused to take those steps necessary to ensure that the Company's stockholders will receive maximum value for their shares of MCA stock. Defendants failed to announce any active auction or open bidding procedures best calculated to maximize stockholder value in selling the Company.

53. In addition, despite the possible interest of several companies in acquiring MCA, defendants favor an acquisition of the Company by Matsushita which expressed a firm desire to maintain the Individual Defendants and other members of MCA senior management (with whom they are allied) in their positions of control subsequent to the consummation of the Merger. As a result, the Individual Defendants are acting to entrench themselves in their offices and positions and to receive enhanced and substantial salaries

and perquisites, all at the expense and to the detriment of the Company's public stockholders.

54. The Individual Defendants were induced to sell MCA to Matsushita for a grossly inadequate price by Matsushita's payment of the above described substantial payments and benefits to the Individual Defendants, at a time when MCA's common stock was temporarily under-rated as a result of, inter alia, the Company's expansion plan and a temporary decline of the stock market due to world events. As a result, the Individual Defendants are faced with substantial conflicts of interest between the best interests of MCA's stockholders and their own financial gains and continued employment.

55. By the acts, transactions and courses of conduct alleged herein, the Individual Defendants, other than MCA, individually and as part of a common plan and scheme in breach of their fiduciary duties and obligations, have and will unfairly deprive plaintiffs and the other members of the Class of their investment in MCA and to ensure continuance of their positions as directors and officers and enhanced compensation, all to the detriment of the Company and its stockholders. The Individual Defendants have been engaged in a wrongful effort to entrench themselves in their offices and positions of control and prevent the acquisition of the Company except on terms which would further their own personal interests.

56. These events represent the culmination of an entire plan and scheme by which the Individual Defendants have sought to isolate themselves from any acquisition of the

Company except under circumstances directly serving their personal interests at the expense of MCA's public stockholders. Previously, in July 1987, MCA implemented a stockholder rights plan (or "Poison Pill") designed to deter unsolicited takeover bids by making any hostile takeover attempt prohibitively expensive. The Poison Pill was subsequently modified on March 1, 1988 and December 6, 1988, to lower the trigger points at which the plan is activated and otherwise intensify its deterrent impact, thus magnifying the Individual Defendants' power to resist unwanted third party offers.

57. The Individual Defendants have also caused or taken advantage of other entrenchment devices designed to repel any takeover effort not endorsed by them. Among other things, MCA's certificate of incorporation provided for a staggered Board of Directors. Further, the Company entered into lucrative severance agreements ("Golden Parachutes") with five executive officers of MCA, including defendants Wasserman and Sheinberg. The Golden Parachutes provided for cash payments of million of dollars triggered by, among other things, any change in control of the Company. These Golden Parachutes were designed to make an unfriendly acquisition of the Company economically disadvantageous.

58. In addition, defendant Wasserman exercised voting and investment power as to approximately 6 million MCA shares in addition to the approximately 5 million shares which he personally owned. These additional shares were held in a series of trusts and charitable associations over which Wasserman served as a trustee or otherwise exercised control. Aggregating the shares owned directly by

Wasserman with those over which he exercised voting and investment powers as a trustee or in similar capacities, the MCA directors and officers as a group beneficially owned in excess of 13 million MCA shares, constituting approximately 18% of the outstanding common stock. Such aggregate ownership and control reposed in senior management was deliberately structured to frustrate an unwanted bidders' ability to meet the requirements of the Delaware Anti-Takeover Statute.

59. In this regard, in order to meet the requirements of the Delaware Anti-Takeover Statute, 8 Del.C. §203 (the "Delaware Act" or the "Act") for the prompt completion of a second-step "business combination", Section 203(a) requires that (i) prior to purchasing 15 percent or more of MCA common stock, any potential acquiror of the Company obtain approval from the MCA Board of Directors of the proposed "business combination;" (ii) a third party acquire in a single transaction a sufficient number of shares of MCA common stock to go from an ownership position of under 15% to one of over 85% (the "85% Exception"); and (iii) after obtaining 15%, the potential acquiror obtain the approval of the MCA Board and 66-2/3% of the other stockholders to the subsequent "business combination."

60. The ownership and control of MCA stock by the Individual Defendants and senior management therefore effectively placed under their control in excess of 15% of the Company's common stock, thereby preventing a hostile bidder from satisfying the 85% Exception. This had the intended and inevitable effect of frustrating an unsolicited

bidders' efforts to acquire the Company and predictably shifts corporate power to the hands of entrenched management.

61. By virtue of the acts and conduct alleged herein, the Individual Defendants, who control the actions of the Company, have carried out a preconceived plan and scheme to place their own personal interests ahead of the interests of MCA's public stockholders and thereby entrench themselves in their offices and positions within the Company. The Individual Defendants have violated their fiduciary duties owed to plaintiffs and the Class, including their fiduciary duties of complete candor, in that they have not and are not exercising independent business judgment and have acted and are acting to the detriment of MCA's public stockholders for their own personal benefit.

62. The Individual Defendants have breached their fiduciary duties by reason of the acts and transactions complained of herein, including their decision to effect the Merger with Matsushita without making any effort to obtain the best offer possible, by affirmatively attempting to prevent a better offer, and by failing to disclose material facts to MCA's stockholders.

63. As a result of the actions of the Individual Defendants, plaintiffs and the other members of the Class have been and will be damaged in that they have not and will not receive their fair proportion of the value of MCA's assets and business and/or have been and will be prevented from obtaining a fair and adequate price for their shares of MCA's common stock.

64. Defendants have subjected MCA to potential liability under the federal securities laws, thus causing MCA to expend and waste corporate assets that could otherwise be utilized for the benefit of MCA's public stockholders.

65. Plaintiffs seek preliminary and permanent injunctive relief and declaratory relief preventing defendants from inequitably and unlawfully depriving plaintiffs and the Class of their right to realize a full and fair value for their stock at a substantial premium over the market price, and to compel defendants to carry out their fiduciary duties of candor and to maximize shareholder value in selling MCA.

66. Plaintiffs and the Class have no adequate remedy at law. Only through the exercise of this Court's equitable powers can plaintiffs be fully protected from the immediate and irreparable injury which defendants' actions threaten to inflict.

67. Unless enjoined by the Court, defendants will continue to breach their fiduciary duties owed to plaintiffs and the other members of the Class, and/or aid and abet and participate in such breaches of duty, and will consummate the Tender Offer and the Merger with inadequate disclosure and at an inadequate and unfair price, or upon inequitable terms, all to the irreparable harm of plaintiffs and the other members of the Class.

68. Plaintiffs and the Class have no adequate remedy at law.

Appendix D

WHEREFORE, plaintiffs demand judgement as follows:

(a) Declaring this to be a proper class action and certifying plaintiffs as representatives of the Class;

(b) Ordering the Individual Defendants to carry out their fiduciary duties to plaintiffs and the other members of the Class by announcing their intention to:

i) cooperate fully with any person or entity, having a bona fide interest in proposing any transaction which would maximize stockholder value, including, but not limited to, a buyout or takeover of the Company;

ii) undertake an appropriate evaluation of MCA's worth as a merger/acquisition candidate;

iii) take all appropriate steps to enhance MCA's value and attractiveness as a merger/acquisition candidate;

iv) take all appropriate steps to effectively expose MCA to the marketplace in an effort to create an active auction for MCA;

v) act independently so that the interests of MCA's public stockholders will be protected;

vi) adequately ensure that no conflicts of interest exist between the Individual Defendants' own interest and their fiduciary obligation to

maximize stockholder value or, if such conflicts exist, to ensure that all conflicts are resolved in the best interests of MCA's public stockholders; and

vii) adequately disclose the personal interests of and benefits to the Individual Defendants in the Merger;

viii) declaring that defendants and each of them have committed or aided and abetted a gross abuse of trust and have breached their fiduciary and other duties to plaintiffs and the other members of the class;

ix) preliminary and permanently enjoining defendants and their counsel, agents, employees and all persons acting under, in concert with, or for them, from proceeding with, consummating or closing the proposed transaction which will irreparably harm plaintiffs and the class;

x) in the event the proposal is consummated, rescinding it and setting it aside, or awarding rescissory damages if it cannot be set aside;

(c) Ordering the Individual Defendants, jointly and severally, to account to plaintiffs and the Class for all damages suffered and to be suffered by them as a result of the acts and transactions alleged herein;

(d) Awarding plaintiffs the costs and disbursements of this action, including a reasonable allowance for plaintiffs' attorneys' and experts' fees; and

Appendix D

(e) Granting such other further relief as may be just and proper under the circumstances.

Dated: December 14, 1990

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Supreme Court, U.S.
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No. 99-417

IN THE

Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

Petitioners,

v.

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

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INTRODUCTION

This petition raises important questions concerning the conditions necessary for a class action judgment to have preclusive effect on absent class members. Respondents silently concede that the legal positions they espouse directly conflict with those advanced by three members of this Court in *Matsushita*, 516 U.S. 367 at 395 (1996) *et seq.*, as well as the Restatement (Second) of Judgments, *id.* at 396, and the leading treatises.[1] This case, accordingly, provides an ideal vehicle for this Court to resolve the issues raised because respondents' opposition also shows that there is *no* material factual dispute.

First. Respondents do not deny -- not even faintly -- that all four federal circuit judges who examined the record found inadequate representation, using such terms as "hostile," "subversive]" and "collusion". Nor do respondents challenge Judge Wiggins' statement that the evidence of inadequate representation was "*convincing[].*" App. 20a. Nor do they deny that the Delaware court said that "suspicions [of collusion] abound" and then *incorrectly* put the burden of proof "on collusion" on the objectors. Pet. at 18-19.

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[1] In a lengthy and approving analysis of Judge Norris' opinion, now withdrawn, at 18 Wright, Miller & Cooper, Federal Practice and Procedure § 4455 (1999 Supp.), the authors assert "it has long been the general understanding . . . that only adequate representation can justify preclusion against absent class members. . . . The Ninth circuit opinion is a strong statement of the traditional view." Respondents reinterpret the federal decisions, Pet. at 12-14, to focus solely on notice. Resp. Br. at 12-13. And they ignore the explicit holding of the Delaware Supreme Court in *Prezant v. DeAngelis.*

Respondents *necessarily* contend, therefore, that a class action judgment is binding *despite inadequate representation* in fact.

Second. Respondents concede (Resp. Br. at 10-11 n.4) that in the Delaware proceeding there was no inquiry whatsoever into the Delaware plaintiffs' membership in the class, and their capacity to represent it, let alone whether they had represented it adequately. Respondents state that the complaint alleged the Delaware plaintiffs were owners of stock "and this contention was uncontested" (Resp. Br. at 11 n.4). The complaint was unverified,[2] and respondents' statement simply confirms Judge Thomas's analysis (App. 22a) that there was *no* record *evidence* of any kind that the named plaintiffs were even members of the settling class. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 625-26 (1997) ("a class representative must be part of the class"). Moreover, respondents do not deny that, when they sought certification as class representatives, any federal claims they held were time barred, as Judge Thomas observed. App. 25a; Pet. at 17. To allow plaintiffs whose own claims are time barred to represent classes is in direct conflict with federal case law. *E.g.*, *Great Rivers Cooperative of SE Iowa v.*

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[2] Respondent Appendix 47a. Even if the allegations of ownership (made on information and belief alone) were true, plaintiffs' allegations are insufficient to make them members of the subclass of Delaware plaintiffs who once had federal claims. They did not allege that they *tendered* their shares. There must be a purchase or sale of securities to trigger federal rights under the Exchange Act. Moreover, the complaint did not contain even a formal allegation that plaintiffs would adequately represent the class.

Farmlands Industries, Inc., 120 F.3d 893, 899 (8th Cir. 1997); Pet. at 17.

Respondents *necessarily* contend, therefore, that a class constituted at a fairness hearing simply on the basis of an oral argument, without evidence, and with no litigant with viable claims before the court, can give rise to a valid class judgment if no one objects.

Respondents' fundamental position -- that there can be *no* challenge to a class action judgment in any court, so long as that court has Rule 23 or its functional equivalent, and the court makes a journal recital of adequate representation (Resp. Br. at 10 n.3) wholly eliminates any "due process check" (Ginsburg, J., 516 U.S. at 389) on class action judgments. This means that, contrary to the settled law, 516 U.S. at 395 (Ginsburg, J.), the class action court *can* conclusively determine the *res judicata* effect of its own judgment so long as it simply recites that "adequate representation" existed.

At the same time, as they transform the "due process check" into whether the class action court purported to employ certain procedures, respondents and the Ninth Circuit do not extend the necessary procedures beyond the bare text of Rule 23. Thus, for them, it is irrelevant that the class notice did not list adequacy of representation as an issue (App. 28a), nor did the judgment initially submitted by the settling parties include a finding with respect to it; that the complaint was unverified and, in any event, did not show that anyone was constitutionally competent to surrender the federal claims; that that while "suspicions [of collusion] abound" the vice chancellor *incorrectly* placed the burden of proof upon the objectors. For respondents, a perfunctory

recital of adequate representation in a judgment submitted by the litigants is sufficient to bind absent class members, whatever the actual status of the proceedings.

This Court's guidance is imperatively needed. This Court should not permit well understood class action principles to be thrown into confusion. This is a case in which there is convincing and unrebutted evidence of inadequate representation. This case provides an ideal vehicle for this Court to emphasize the importance of the requirement that adequate representation must exist "at all times" if a class action judgment is to bind absent class members. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985); *Ortiz v. Fibreboard Corp.*, 119 S.Ct. 2295, 2315 n.24 (1999). Rigorous insistence upon this requirement is indispensable to the very legitimacy of the class action mechanism. In a world of multiple class actions, insistence upon this requirement is especially vital if the defendant is to be prevented from simply "auctioning off" a settlement to the lowest "bidder."[3]

I. RESPONDENTS' CLAIMS CONFLICT WITH ESTABLISHED LAW.

Respondents press a wide range of claims in the hope of deflecting attention from their concessions.

A. Adopting the position of the panel majority below, respondents insist (p. 9) that "a federal court is to consider only whether the state court *procedures* are adequate

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[3] This has been aptly described as a "reverse auction", because defendants, in effect, sell to the lowest bidder. John C. Coffee, Jr., *Class Wars*: The Dilemma of the Mass Tort Class Action, 95 Colum. L. Rev. 1343, 1354 (1995).

to ensure that the parties have a full and fair opportunity to litigate their claims; . . ."

(i) We have examined this argument at length. Pet. at 11-15. Adequate representation does not mean just adequate procedures. If a class member is to be bound by representation, his representative must *actually* represent the class member "at all times", not just, as respondents claim, only at the point at which the class representative examines the forum's procedures. As Judge Norris said, citing *Hansberry*, "No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause." App. 56a. Adequate representation "at all times" is a condition indispensable to the legitimacy of the class action. A contrary rule is license for fraud, as Judge Thomas observed, and will have especially deleterious result in the now familiar context of competing class actions. As we have said (p. 1), respondents *silently concede that their legal position is directly in conflict with the views expressed by three members of this Court as well as the Restatement (Second) of Judgements*. Respondents cite no authority for their proposed rule, and then simply ignore *Shutts*' statement that adequate representation must exist "at all times". [4] That duty is a "continuing one," as Justice

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[4] Respondents sometimes suggest that the right to opt out is a due process solvent (pp. 14-15 n.7). This is inconsistent with *Shutts*, a case in which that right existed. It is also inconsistent with Delaware law. *Prezant v. De Angelis*, 636 A.2d 915, 924 n.6 (1994), rejects the scattered line of authority upon which respondents rely. As Wright, Miller and Cooper observe, "Actual notice, the opportunity to opt-out – when it is afforded, the opportunity to appear and participate, and the opportunity to object

Ginsburg said. 516 U.S. at 395.

(ii) However, even on respondent "procedures only" approach, the Delaware proceedings were "fundamentally flawed". As we note (p. 1), respondents concede that no inquiry ever was made into the capacity of the named plaintiffs to represent the class. A class cannot be constituted on the basis of allegations, Pet. at 16-17 n.10, and most assuredly not only on the basis of oral argument. To bind, *the record must contain record evidence of some kind* on that issue. *Prezant, supra*, 636 A.2d at 924, squarely so holds; *see also* 516 U.S. at 397 (Ginsburg, J.). Moreover, the Delaware court put the burden on the wrong party, the objectors, and the wrong burden at that: actual collusion rather than simply inadequate representation.[5] The Delaware proceedings were, accordingly, "fundamentally flawed".

B. Unwilling in the end to rely upon the Ninth Circuit's analysis, respondents also insist that the issue of adequacy of representation was "fully and fairly litigated" in Delaware, and that binds absent class members. Resp. Br. at 8. As a factual matter, that claim is without record support. As Judge Thomas noted, the term adequate representation was

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to settlement, are opportunities. They are not obligations." 18 *Federal Practice and Procedure* § 4455 (1999 Supp.)

[5] In the process the vice chancellor ignored the fact that inadequate representation is not the same as collusion. As Judge Thomas noted, "The fact that there was no finding of wrongdoing certainly does not preclude a finding that the federal plaintiffs were inadequately represented by the settling class." App. 29a. And the vice chancellor compounded his error by placing the burden of proof on the objectors. In this Court, respondents conceded at oral argument that the burden was on them. App. 111a.

mentioned only once in the entirety of the Delaware proceeding, and then only in the context of an affidavit urging the vice chancellor to beware of the settlement proposed by the Delaware plaintiffs who had previously shown themselves to have been inadequate in the first settlement rejection. App. 43a. Many critical arguments bearing upon inadequate representation -- such as the richly documented Delaware class counsel's numerous misrepresentations as to the content of federal securities law and the status of federal proceeding (App. 26a, 69a, 80a) and the constitutional requirement that the class representations have *some* litigable claims -- were never mentioned at all. If litigation can be "full and fair" in such circumstances, this Court's guidance is needed on that concept too.[6]

More fundamentally, the conduct of the Delaware objectors could not conclusively bind absent class members. As Judge Norris said, "Objectors are objectors, not class representatives." App. 45a, 47a. No Delaware statute authorizes objectors to act on behalf of the class[7]; nor were

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[6] Respondents' efforts to treat petitioners as "present" through a surrogate in Delaware is one they have urged throughout this lengthy litigation. No judge has given it credence, because the evidence is indisputable that petitioners neither solicited, financed, nor controlled any of the objectors. *Montana v. United States*, 440 U.S. 147 (1979). In particular, objector Krupman's counsel submitted his own work for his own client.

[7] For that reason, the manner and scope of the objectors' participation is completely within the control of the judge. Patrick Woolley, *Rethinking the Adequacy of Adequate Representation*, 75 Texas L. Rev. 571, 580-81 (1997) (noting absent class members' limited right to participate).

they authorized by the class to do so, as Judge Thomas observed. App. 30a. And there is no evidence that they voluntarily undertook the heavy fiduciary duties and responsibilities associated with class representation.[8] As the First Circuit recently noted in rejecting a claim by objectors, objectors do not owe fiduciary duties to the class. Only class representatives do. *Duhaime v. John Hancock Mutual Life Ins. Co.*, 183 F.3d 1, 5 (1999).

II. THIS CASE DOES NOT INVOLVE OPEN ENDED CHALLENGES

Respondents seek to portray petitioners as contemplating open ended challenges to class action settlements. This is clearly wrong. This is *not* a case where the federal court was called upon to engage in open-ended, free-wheeling, second-guessing of the judgment of the class action court on the quality of representation by class counsel. Far from it. The Delaware court never addressed that issue, except to say that "suspicions [of collusion] abound"; this is a case where all four circuit judges concluded that representation by class counsel was, beyond contradiction, inadequate representation, and it is a case in which, as Judge Wiggins observed where there was "*convincing[]*" evidence of inadequate, indeed "*hostile*" representation. App. 20a. Due process precludes full faith and credit for such a judgment.

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[8] Judge Thomas quite properly characterized the Delaware objectors as "inadequate." App. 31a.

III. THIS COURT LEFT OPEN WHETHER THE DELAWARE JUDGMENT VIOLATED DUE PROCESS

Respondents insist that the panel majority was simply "implementing" this Court's decision in *Matsushita*, and that this Court necessarily decided that the Delaware judgment satisfied due process. In that process, they do not even mention footnote 5's express reservation of the issue, or the numerous decisions of this Court (Pet. at 20 n.13) relying upon that "we do not decide" language.[9] We have addressed this issue in detail. Pet. at 19-22. We simply note here that footnote 5 is not a "hint" to the lower courts to substitute impressionism for doctrinal analysis in treating issues the Court has explicitly reserved. Footnote 5 is, as we have said (Pet. at 20) a holding of the Court, one that was necessary for its full disposition of the appeal. As we point out (Pet. at

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[9] Respondents' reference (p. 5) to the Court's statement that "we think a Delaware court would afford preclusive effect to the settlement judgment in this case" refers to a very different issue: the scope of Delaware preclusion law on "global" settlements. This Court believed that Delaware applied a "same transaction" test, not the narrower "operative fact" test to measure the state court's right to release federal claims. Justice Ginsburg, on this issue joined by Justice Stevens but not Justice Souter, dissented from the Court's "endeavor to forecast Delaware preclusion law." 516 U.S. at 394 n.4. Commentators clearly understood that the Court's references were to the content of Delaware preclusion law. *Exclusive Federal Jurisdiction*, 110 Harv. L. Rev. 297, 303-305 (1996), and that adequacy of representation was open on remand, *id.* at 302, 307 n.79 ("The lower [federal] courts will have the final say and most likely will withhold preclusion because of the glaring due process inadequacies").

19-20) this Court must retain for itself alone the authority to decide what it has and has not decided if it is to fulfill its institutional role in the American legal system.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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